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# Center for Real Estate Quarterly, Volume 8, Number 4

Portland State University. Center for Real Estate

# CENTER FOR REAL ESTATE

## Quarterly Report

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# **CENTER FOR REAL ESTATE** Quarterly Report

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# DENSITY AT ANY COST

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In September, the Portland region's Metro government released its draft 2014 Urban Growth Report. This Report deserves special attention by citizens and professionals in the local business community because it distorts economic data and will lead the region to make decisions that will harm economic growth. Much of the economic damage comes from an unrealistic view of housing markets, where the plan envisions a doubling of apartment rents over twenty years, creating a large burden for low-income households in the region. In addition, the plan assumes multi-billion dollar unfunded mandates on local government to subsidize housing and transportation projects. And ironically, the Metro plan is likely to cause net environmental harm to the global climate by shifting population growth from our region to places in the southeast and southwest United States where carbon emissions will be higher. In this article, I will explain the purpose of Metro's study and outline the implications of this Report.

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## BACKGROUND

Under Oregon's land use laws, local governments are required to assess the capacity of their urban growth boundary (UGB) every five years and determine whether the UGB contains sufficient land supply to support 20 years worth of population growth and employment growth. In the case of the Portland region, the elected regional government, Metro, produces a demographic and economic forecast for the region to begin this planning process. The anticipated growth is then allocated between the Portland Metro jurisdiction and non-Metro locations in Clark County, Washington, and exurban communities such as Woodburn and Newberg. Metro then consults local governments to assess their capacity to receive that growth, using existing zoning regulation to estimate the supply potential of the region. The reconciliation of demand and supply of residential and employment land determines if the Urban Growth Boundary needs to be expanded.

Metro's UGB was established in the late 1970's and was initially set with a lot of capacity for future growth. In part due to the extended economic recession of that period, Metro's UGB was not significantly expanded in the 1980's. Economic growth in the region picked up in the 1990's, and using the process described above, Metro has expanded the Urban Growth Boundary in 1996, 2001, 2006, and 2011, primarily in eastern Clackamas County, but also in parts of Multnomah County and Washington County. That process hasn't produced many of the results anticipated since a large newly created jurisdiction, Damascus, lacked the infrastructure for development and many local citizens have resisted urbanization.

Part of the failure of Metro's expansion in the Damascus area of Clackamas County can also be blamed on the weak housing demand in Damascus. State rules governing UGB expansion call for UGBs to be expanded in places of low agricultural productivity, protecting land with high agricultural potential. The highest valued farmland in the exurban areas of Portland tends to be located in Washington County, where land is more flat, well drained, has good highway access, and has a better climate than the eastside. Unfortunately, housing development is also more attractive in places with flat land, well-drained soils, better highway access, and milder climates (along with good school quality and employment access). In effect, state land use rules that force UGB expansion in low-value agricultural land in the eastside has meant that the region has received relatively little housing production per acre when expanding the UGB.

Frustration with the UGB expansion process and with legal challenges by environmental interests to UGB expansion led the Oregon State Legislature to decide in March, 2014, to expand the UGB in the Portland and Salem metropolitan areas by statute. While the legislative decision largely validated administrative decisions that Metro had already made, it questions whether the focus for land use decision-making is moving from Metro headquarters to the state legislature in Salem.

## METRO'S URBAN GROWTH REPORT AND THE IMPACT ON HOUSING COSTS

In recent UGB decisions, Metro has used a spatial planning model known as Metroscope, which assigns population and employment to parcels in the region. Although the description of the Metroscope model uses the words "demand" and "supply", it's important to recognize that Metroscope is not an economic forecasting model that tries to understand the decision by firms and households to locate inside or outside the region or undertand what type of housing they want. Rather, Metroscope is a population and employment assignment model that treats the region's urban growth boundary as paramount. Within the model, households and firms must locate within the UGB should any zoning capacity exist, even if that capacity can only be utilized at very high cost. Moreover, residential zoning within the City of Portland is relatively generous, whether measured as height limits or as floor area ratio. However, much of that generously zoned land is already developed and will be unlikely to develop to its full extent in any conceivable time horizon. Nevertheless, given the programming of the Metroscope model, the zoning capacity within the City of Portland acts as a sponge to soak up any potential housing demand.

The impact of the excessive zoning for multi-family in the City of Portland can be seen in the following table showing the percentage of single-family housing and multi-family housing in the Portland region over the last 55 years compared to the projected 20 years in the Metro plan. Historically, the Portland region's housing stock has comprised of about two-third single-family homes and one-third multi-family housing. As land has become more expensive, multi-family housing has become more popular, but we still produce about 60% single-family housing and 40% multi-family housing. In the Urban Growth Report, Metro staff have become fixated on the last five years of building permit data, when the national economy was in crisis, home values deteriorated, consumers lost confidence in homeownership, and the federal government was the dominant supplier of credit, largely for multi-family housing. Using a limited amount of data, they have produced an unbelievable housing production forecast.

**Table 1: Single family vs. multi-family housing, tri-county region**

| Census Year | Single Family | Multi Family |
|---|---|---|
| 1960 | 85% | 15% |
| 1970 | 76% | 24% |
| 1980 | 81% | 19% |
| 1990 | 80% | 20% |
| 2000 | 74% | 26% |
| 2010 | 70% | 30% |
| Units Built 1960-2010 | 60% | 40% |
| Metro Plan, 2015-35 | 36% | 64% |

Source: Metro staff, Metro Urban Growth Report

To achieve that level of multi-family development inside the urban growth boundary, Metro projects that 92,911 of the 205,780 housing units produced in the next 20 years (45.1%) will be built at a density level of 46 units per acre of greater. 35.9% of the units produced will be built at the Pearl District density level of 101 units per acre or higher. By comparison, mostly single-family neighborhoods in East Portland were developed at 8 units per acre. In addition, a staggering 77% of the housing capacity of the region is estimated to come from redeveloped property or neighborhood infill, which means that for most housing projects built, some existing housing or business will need to be demolished. The City already faces considerable neighborhood discontent from apartment construction and the loss of on-street parking, adding to the doubts that this level of density will materialize. In the Report, Metro assumed that 60.2% of future housing unit production will happen in the City of Portland, 92% of which is multi-family construction, a complete reversal of historic trends. However, in the Metroscope model, housing preferences play no role, only zoning capacity.

While the Metroscope model provides an unrealistic model of existing housing capacity, it does provide us a measure of the costs and tradeoffs. One of the refinements of the Metroscope model in recent years recognized that increasing housing density requires higher apartment rents. Under current market conditions, for example, development of garden apartments (two-story structures with surface parking) require apartment rents of at least $1.00-$1.20 per square foot. Mid-rise apart-

ment construction (five story buildings with structured parking) require rents in the $1.70-$2.10 per square foot range. And high-rise construction (greater than 5 stories, often requiring steel construction and underground parking) require rents in the $2.70-$2.90 per square foot range. As a general rule, these higher density developments tend to occur in the central neighborhoods of the City of Portland, where rents tend to be highest.

As a result, when the Metroscope model looks for additional housing capacity, it must hit considerably higher rents in order to fit the 20-years of population growth inside the existing UGB. In addition, Metroscope treats single-family homes and apartments as perfect substitutes for another, regardless of household preferences. As a result, when the model has to accommodate a new household that would normally prefer a single-family home, it scours the region to find one. When it cannot, it assigns that household to a newly built multi-family structure. Much of the land zoned for multi-family is currently occupied by lower density structures, so the multi-family development requires some demolition and additional housing demand, which then needs to accommodated by yet more high cost multi-family construction.

The amount of the increase in prices required by Metroscope to fit the growth in population inside the current UGB is staggering. Table 4 from Appendix 4 of the Urban Growth Report compares the inflation-adjusted prices in the baseline year (2015) with those in 2035. When you compare the projected prices by "value class" or household type, and add a 2-3% factor for inflation, you find that Metroscope is projecting a doubling of apartment rents and home prices in the region.

For example, if we look at household type 5, we find the estimated monthly rent rises from $570 to $774 per month in inflation-adjusted terms. If we add an inflation factor of 2.5% per year, the rent level will more than doubles from $570 to $1,268. Averaged across the eight household types, we find average rents rising by 124%.

Table 4: Baseline - medium growth scenario

## Residential Demand by Value Class

5/19/2014

MetroScope UGR Scenario #1462 Results

### 2015

**UGB 2015**

| Value Class | Total Residential Demand (units) | | | | Residential Prices | | Est. Monthly Rent | |
|---|---|---|---|---|---|---|---|---|
| | Owner Single Family | Owner Multi-family | Renter Single Family | Renter Multi-family | Owner Single Family | Owner Multi-family | Rental Single Family | Rental Multi-family |
| 1 | 32,134 | 3,981 | 2,304 | 17,174 | $ 85,062 | $ 82,228 | $ 594 | $ 341 |
| 2 | 34,995 | 2,971 | 9,215 | 32,778 | 120,071 | 116,423 | 790 | 384 |
| 3 | 41,831 | 3,116 | 6,715 | 28,651 | 146,220 | 146,930 | 969 | 449 |
| 4 | 41,709 | 1,910 | 8,045 | 26,407 | 174,310 | 166,718 | 1,136 | 502 |
| 5 | 45,403 | 2,308 | 5,827 | 21,694 | 211,744 | 203,193 | 1,314 | 570 |
| 6 | 46,250 | 1,771 | 9,891 | 26,187 | 240,862 | 228,855 | 1,505 | 647 |
| 7 | 43,644 | 1,112 | 10,938 | 24,263 | 308,826 | 278,718 | 1,814 | 763 |
| 8 | 45,834 | 1,104 | 14,451 | 18,389 | 485,427 | 434,509 | 3,168 | 1,167 |
| | 331,800 | 18,273 | 67,386 | 195,543 | | | | |
| | 54% | 3% | 11% | 32% | | | | |

### 2035

**UGB 2035**

| Value Class | Total Residential Demand (units) | | | | Residential Prices | | Est. Monthly Rent | |
|---|---|---|---|---|---|---|---|---|
| | Owner Single Family | Owner Multi-family | Renter Single Family | Renter Multi-family | Owner Single Family | Owner Multi-family | Rental Single Family | Rental Multi-family |
| 1 | 36,699 | 14,726 | 2,454 | 27,487 | $ 126,987 | $ 105,755 | $ 764 | $ 467 |
| 2 | 44,988 | 15,488 | 8,464 | 40,720 | 182,219 | 162,159 | 956 | 522 |
| 3 | 46,189 | 11,101 | 5,430 | 36,715 | 225,363 | 210,320 | 1,113 | 591 |
| 4 | 55,806 | 10,406 | 7,340 | 37,894 | 268,789 | 245,241 | 1,338 | 678 |
| 5 | 53,118 | 8,079 | 7,735 | 34,186 | 321,264 | 297,240 | 1,587 | 774 |
| 6 | 59,070 | 6,749 | 9,220 | 32,249 | 368,411 | 344,918 | 1,892 | 895 |
| 7 | 53,702 | 3,203 | 10,059 | 29,589 | 454,937 | 429,537 | 2,309 | 1,065 |
| 8 | 59,853 | 3,940 | 16,393 | 31,048 | 734,872 | 699,781 | 4,091 | 1,636 |
| | 409,425 | 73,692 | 67,095 | 269,888 | | | | |
| | 50% | 9% | 8% | 33% | | | | |

*Note: "value class" refers to the aggregation of household characteristics attributed by household size, income, and age of householder (i.e., HIA) into eight household types as shown in Table 4.*

**Table 2: Home prices and rents**

| Household Group | Apartment Rent | | | | |
|---|---|---|---|---|---|
| | 2015 | 2035 ($2015) | 2035 | Real increase | Nominal increase |
| 1 | $341 | $467 | $765 | 37% | 124% |
| 2 | $384 | $522 | $855 | 36% | 123% |
| 3 | $449 | $591 | $968 | 32% | 116% |
| 4 | $502 | $678 | $1,111 | 35% | 121% |
| 5 | $570 | $774 | $1,268 | 36% | 123% |
| 6 | $647 | $895 | $1,467 | 38% | 127% |
| 7 | $763 | $1,065 | $1,745 | 40% | 129% |
| 8 | $1,167 | $1,636 | $2,681 | 40% | 130% |
| | | | | 37% | 124% |

| Household Group | Single Family House Price | | | | |
|---|---|---|---|---|---|
| | 2015 | 2035 ($2015) | 2035 | Real increase | Nominal increase |
| 1 | $85,062 | $126,987 | $208,083 | 49% | 145% |
| 2 | $120,071 | $182,219 | $298,587 | 52% | 149% |
| 3 | $146,220 | $225,363 | $369,284 | 54% | 153% |
| 4 | $174,310 | $268,789 | $440,442 | 54% | 153% |
| 5 | $211,744 | $321,264 | $526,428 | 52% | 149% |
| 6 | $240,862 | $368,411 | $603,684 | 53% | 151% |
| 7 | $308,826 | $454,937 | $745,467 | 47% | 141% |
| 8 | $485,427 | $734,872 | $1,204,173 | 51% | 148% |
| | | | | 52% | 148% |

Source: Metro, author's calculations

On the homeownership side, the price increase required in the Metro Urban Growth Report is even more dramatic, with housing prices growing by a factor of 148% over the 20-year planning horizon. The PSU Center for Real Estate finds the median house price in the region at $290,000 in the third quarter of 2014. An increase of 148% over 20 years would mean a median house price of $719,000 in 2035.

What would be the impact of this level of housing price and rent appreciation? To assess this, I've created a table of median apartment rents by metropolitan area for the largest 20 metropolitan areas, including a few additional west coast competitors.

Rents vary across metropolitan areas for a variety of factors, including total population, employment opportunities, land availability, and amenities within that region.

**Table 3: Median gross rent by metropolitan area**

| | 2009 | | 2035 (projected) |
|---|---|---|---|
| San Francisco | $1,303 | San Francisco | $2,476 |
| Washington | $1,303 | Washington | $2,476 |
| San Diego | $1,224 | San Diego | $2,326 |
| Los Angeles | $1,197 | Portland | $2,281 |
| New York | $1,125 | Los Angeles | $2,275 |
| Boston | $1,123 | New York | $2,138 |
| Miami | $1,077 | Boston | $2,134 |
| Seattle | $1,015 | Miami | $2,047 |
| Sacramento | $998 | Seattle | $1,929 |
| Atlanta | $912 | Sacramento | $1,896 |
| Philadelphia | $912 | Atlanta | $1,733 |
| Phoenix | $912 | Philadelphia | $1,733 |
| Chicago | $900 | Phoenix | $1,733 |
| Denver | $876 | Chicago | $1,710 |
| Portland | $876 | Denver | $1,665 |
| Houston | $848 | Houston | $1,611 |
| Dallas | $846 | Dallas | $1,608 |
| Minneapolis | $840 | Minneapolis | $1,596 |
| Salt Lake City | $835 | Salt Lake City | $1,587 |
| Detroit | $783 | Detroit | $1,488 |
| St. Louis | $732 | St. Louis | $1,391 |
| Cleveland | $695 | Cleveland | $1,321 |

2009 American Community Survey, US Census Bureau, author's calculations

In 2009, Portland fits in the middle of the pack among competing Western metro areas like Denver and Phoenix, and national competitors like Dallas, Minneapolis. and Chicago. Firms considering relocation from the Bay Area or Seattle can suggest to their employees that they will pay lower housing costs. To simulate the situation in 2035, we increase the rents in all metropolitan areas by 2.5% per year, roughly equal to the rate of inflation in the last two decades. If rents were to rise by 37% in inflation-adjusted terms, the median Portland area rent would rise to $2,281, roughly equal to levels in Los Angeles, San Diego, or San Francisco, eroding an important comparative advantage for the region. Yet nothing in Metro's planning effort accounts for the impact of these cost increases on the region's economic competitive-

ness. That is, Metroscope records the price levels required for development to match the density levels anticipated in the plan, but does not consider the competitive implications of such a price shift.

## METRO'S URBAN GROWTH REPORT AND INCOME INEQUALITY

Metro's Report attempts to reconcile these cost increases with housing choices and income inequality. In terms of the housing choice between single-family and multi-family housing, Metro anticipates that 63% of the increase in housing demand in 2015-35 will come in the form of multi-family housing and 37% from single family housing. That split is a complete reversal of the traditional 40%-60% split that the region has experienced. And to reconcile the shift from single family to multi-family with underlying preferences for ownership housing, Metro forecasts a tripling of condominium ownership from 3% to 9% of the housing stock. Both of these shifts in housing type suggest a decline in average housing unit size since multi-family housing tends to be considerably smaller than single family housing, making the region's housing stock less family-friendly. In other words, Metro is forecasting a large increase in housing prices and an unprecedented decrease in housing unit size and quality.

In terms of income inequality, the large projected increases in housing costs work greatly to the disadvantage of low-income households. Housing expenditures as a percentage of income tend to decline with income. A household in the lowest 10% of incomes spends an average of 50% of their income in housing, whereas a household in the highest 10% of income spends about 10% of their income in housing. As a result, any policy that increases housing prices will be regressive and exacerbate income inequality in the region. While some local homeowners may enjoy the increase in the value of their property, higher income households own more property and will receive proportionately greater wealth gains. Moreover, existing homeowners cannot enjoy the benefits of that increase until they leave the region, and young homeowners will face a high cost for entering the housing market.

The authors of Metro's Urban Growth Report discuss the question of housing burdens and inequality in Appendix 12. However much of the analysis on Appendix 12 is inconsistent with other parts of the Urban Growth Report. Whereas in Appendix 4, the table presented above clearly shows that inflation adjusted rents rise by 37% and home prices by 52%, Tables 1 and 2 of Appendix 12 suggest that overall housing costs will fall from 2010 to 2035 by 8.5% ($21,200 to $19,400 per year) and apartment rents will rise by only 5.4% ($9,200 to $9,700 per year).

Table 1: Housing and transportation costs for all households in UGB (2010$)

| Year | Median income | Average housing expenditure | Average transportation expenditure |
|---|---|---|---|
| 2010 | $70,800 | $21,200 | $6,400 |
| 2035 low growth scenario | $69,500 | $18,900 | $5,200 |
| 2035 medium growth scenario | $69,400 | $19,400 | $5,200 |
| 2035 high growth scenario | $69,200 | $20,100 | $5,200 |

Table 2: Housing and transportation costs for renter households in UGB (2010$)

| Year | Median income | Average housing expenditure | Average transportation expenditure |
|---|---|---|---|
| 2010 | $39,300 | $9,200 | $4,700 |
| 2035 low growth scenario | $40,400 | $9,500 | $3,600 |
| 2035 medium growth scenario | $40,300 | $9,700 | $3,600 |
| 2035 high growth scenario | $40,100 | $10,000 | $3,600 |

In attempting to reconcile these numbers, Metro officials point to the unprecedented decline in prices following the housing bust of 2007-2011 and they cite, "The large shift from more expensive single family housing units to cheaper multi-family units." The first argument doesn't make sense since housing prices are actually higher today than in 2010. In fact, the latest numbers from the Case-Shiller housing price index show that the Portland single-family housing market has returned to the go-go days of the last decade. We need the regional government to add to land supply to meet that demand, rather than come up with numbers to make us feel good about the escalating costs. On the second point, Metro officials return to the refrain that citizens should adjust to the rise in prices by consuming smaller, lower-quality units.

**Table 4: Portland metropolitan area home prices, Case-Shiller price index, August**

| | | |
|---|---|---|
| 2001 | 108.8 | 5.4% |
| 2002 | 112.9 | 3.8% |
| 2003 | 121.7 | 7.7% |
| 2004 | 130.9 | 7.6% |
| 2005 | 155.0 | 18.5% |
| 2006 | 181.0 | 16.8% |
| 2007 | 186.0 | 2.8% |
| 2008 | 171.9 | -7.6% |
| 2009 | 150.5 | -12.5% |
| 2010 | 147.0 | -2.3% |
| 2011 | 135.9 | -7.6% |
| 2012 | 140.8 | 3.6% |
| 2013 | 159.1 | 13.0% |
| 2014 | 170.7 | 7.2% |

Source: Standard and Poor's

In fact, the authors of Appendix 12 appear to dismiss the possibility that high housing costs could ever become a burden for young homeowners.

"Defining cost-burden for homeowners is somewhat more difficult than rents since many homeowners regard their homes as not just a residence but as an investment. Homeowners often spend a substantial burden of their income on their home, but do not necessarily regard these expenditures as a burden. This is particularly the case for affluent homeowners. For these reasons, this analysis assumes that to be cost-burden, a household must rent, not own."

Unfortunately, this analysis ignores that not every household starts the 2015-35 planning process as a homeowner. High housing costs force households to remain renters living in small apartments or force them to choose small condominiums rather than the single-family homes they would prefer.

## METRO'S URBAN GROWTH REPORT AND UNFUNDED LOCAL GOVERNMENT MANDATES

There are two features of Metro's Urban Growth Report that assume large local government subsidies for transportation and housing development. The transportation subsidies appear within Appendix 12 of the Urban Growth Report, which was ostensibly written to show the burden of the Urban Growth Report on income inequality.

In this Appendix, Metro has chosen to analyze renter household cost burdens that combine housing and transportation costs as a single amount. Traditionally, housing expenditures above 30% of income are seen as a cost burden. In Metro's analysis, the combination of housing and transportation expenditure can rise to 45% of income before they become a burden. Using the above table, we find that Metro expects the average household inflation-adjusted transportation costs would fall by 18.8% ($6,400 to $5,200) and the average renter household transportation budget would fall by 23.4% ($4,700 to $3,600). What accounts for this dramatic reduction in travel costs? According to the Report, "…Census data point to an increase in the non-auto mode share, which reduces transportation costs, particularly for households with lower incomes residing in apartments. This influences the forecast."

The assumption that we will make large swings in transportation mode share has no basis in fact. Over the last two decades, the mode choice of commuters in the Portland metropolitan area has been remarkably stable, despite significant increases in investment in public transportation. Roughly 80% of Portland metro area workers commute by automobile, mostly on their own, but some in carpools. Transit use has remained steady at about 6% of the workforce. While transit use is cheaper than automobile use, most commuters prefer automobiles over mass transit because transit takes longer or cannot serve the journey they need to make. While they might save money by using transit, they decide to drive to save time and improve their wellbeing.

**Table 5: Transportation mode, journey to work, Portland metropolitan area**

| | 1990 | 2009 |
|---|---|---|
| Automobile, drive along | 72.6% | 71.6% |
| Automobile, carpool | 12.5% | 9.9% |
| Public transit | 6.0% | 6.1% |
| Walk | na | 3.2% |
| Other | 8.9% | 3.1% |
| Work at Home | na | 6.1% |

Source: US Census

Nevertheless, Metro has stated that transportation costs will fall by 18.8% primarily due to the switch from automobile use to non-auto mode shares. What are we to make of this assumption? First, the shift to non-auto modes will greatly increase commuting times, which is a burden to residents. The typical transit commute in the United States takes 47.8 minutes while the typical auto commute takes between 23.9 and 25.2 minutes depending upon whether the person drives alone or carpools. Second, the shift to non-automobile shares will create a large burden to Tri-Met and

local taxpayers. Transit operations are subsidized by local taxes, and the construction of new transit lines requires substantial local and federal subsidies. Metro's Urban Growth Report doesn't quantify the degree of shift from automobile to non-auto share, but it can be estimated using this formula:

$$TAC = AC \times AS + NAC \times (1-AS)$$

Where TAC equals Total Average Cost, AC equals Auto Cost, AS equals Auto Share, and NAC equals Non-Auto Cost. As an example, we can assign zero cost to the non-auto share (i.e., free transit) and use the 2009 percentages of 81.5% auto and 18.5% non-auto, and solve for an auto share that reduces total travel cost by 18.8%:

$$TAC = AC \times 0.815 + 0 \times 0.185$$

$$AC = TAC/0.815 = 1.227\ TAC$$

$$(0.812)\ TAC = 1.227\ TAC \times AS + 0 \times (1-AS)$$

$$AS=0.662$$

Hence, the level of automobile driving would need to fall from the current level of 81.5% to 66.2% of commuters. By comparison, the percentage of commuters who drive in the metropolitan areas of Philadelphia (83.6%), Washington, DC (83.2%), Boston (82.7%), San Francisco (81.0%), and Chicago (81.6%) are much higher. Only the New York metropolitan area has a lower rate of automobile usage at 65.7%. Of course, our region has nothing like the transportation or land use characteristics of these older metropolitan areas that support the higher level of transit use.

To achieve even a modest shift in commuting mode would require enormous subsidies to develop the subway and bus transit lines in those older cities. We know from past experience that the region has spent over $500 million in local tax dollars and over $1 billion in federal tax dollars building new mass transit lines, with very little impact on mode share. And operating the new transit lines would require significant tax increases (or significant fare increases). At present, Tri-Met's transit riders pay 25% of operating costs, with the payroll tax paying the remaining 75%. Therefore under current policies, doubling or tripling our transit ridership would require doubling or tripling the region's payroll tax.

The second major unfunded mandate in Metro's Urban Growth Report comes from assumed subsidies to develop high-density housing projects. In Appendix 11 of the Urban Growth Report, Metro measures the level of subsidies needed to create housing projects in various urban renewal areas and neighborhoods in Multnomah County, Clackamas County, and Washington County. The developer incentives vary from $10,000 per unit to $50,000 per unit, depending upon the location. In part they recognize some of the cost barriers to high-density development outlined earlier in this article.

The amount of housing subsidy expected as part of Metro's program is staggering, almost $3 billion of developer incentives. While the Report says that these subsidies are, "based upon existing programs", none of these programs are currently producing housing on this scale. Moreover, nothing in the Urban Growth Report suggests where these subsidy dollars will come from. 92.4% of the subsidy dollars are identified within urban renewal areas within the City of Portland. In theory, urban renewal dollars are generated by taxes on increases in assessed value within urban renewal areas that public improvements have incentivized. In practice, most property within the Portland metropolitan area is assessed at substantially below its real market value. Because properties are assessed below market prices, assessed values will increase by 3% per year (the maximum allowed by state statute) regardless of any urban renewal investment. And since those increases would likely occur independently of investments in urban renewal spending, a large fraction of those subsidy dollars will come at the expense of other county and city government functions.

Table 5: Areas with modeled assumptions for residential incentive programs

| City of Portland | Type | Incentive per DU | SF DU | MF DU | Total DU |
|---|---|---|---|---|---|
| Central Eastside | Central City | $50,000 | 0 | 1,196 | 1,196 |
| Downtown Waterfront | Central City | $50,000 | 0 | 3,376 | 3,376 |
| North Macadam | Central City | $50,000 | 0 | 10,574 | 10,574 |
| Oregon Convention Center | Central City | $50,000 | 0 | 7,105 | 7,105 |
| River District | Central City | $50,000 | 0 | 5,336 | 5,336 |
| South Park Blocks | Central City | $50,000 | 0 | 787 | 787 |
| Gateway Regional Center | Regional Center | $25,000 | 0 | 4,233 | 4,233 |
| Lents Town Center | Town Center | $10,000 | 682 | 17,209 | 17,891 |
| Education URA (PSU) | Non-Center URA | $10,000 | 0 | 831 | 831 |
| Interstate Corridor | Non-Center URA | $50,000 | 194 | 19,036 | 19,230 |
| NPI - 42nd Avenue | NPI | $10,000 | 14 | 813 | 827 |
| NPI - 82nd Avenue and Division | NPI | $10,000 | 38 | 2,690 | 2,728 |
| NPI - Cully Blvd | NPI | $10,000 | 4 | 1,960 | 1,964 |
| NPI - Division Midway | NPI | $10,000 | 0 | 507 | 507 |
| NPI - Parkrose | NPI | $10,000 | 2 | 339 | 341 |
| NPI - Rosewood | NPI | $10,000 | 61 | 248 | 309 |
| TOD - E 122nd Ave MAX Station | Portland TOD | $10,000 | 6 | 84 | 90 |
| TOD - E 148th Ave MAX Station | Portland TOD | $10,000 | 128 | 1,001 | 1,129 |
| TOD - E 162nd Ave MAX Station | Portland TOD | $10,000 | 4 | 54 | 58 |
| TOD - NE 60th Ave MAX Station | Portland TOD | $10,000 | 1 | 308 | 309 |
| TOD - NE 82nd Ave MAX Station | Portland TOD | $10,000 | 2 | 1,851 | 1,853 |
| TOD - SE Division St | Portland TOD | $10,000 | 1 | 978 | 979 |
| | | | | | |
| **Rest of UGB** | **Type** | **Incentive per DU** | **SF DU** | **MF DU** | **Total DU** |
| Clackamas | Regional Center | $25,000 | 0 | 248 | 248 |
| Gresham | Regional Center | $25,000 | 14 | 365 | 379 |
| Hillsboro | Regional Center | $25,000 | 238 | 408 | 646 |
| Oregon City | Regional Center | $25,000 | 0 | 886 | 886 |
| Tanasbourne/AmberGlen | Regional Center | $25,000 | 8 | 1,553 | 1,561 |
| Gladstone | Town Center | $10,000 | 10 | 0 | 10 |
| Lake Oswego | Town Center | $10,000 | 3 | 33 | 36 |
| Rockwood | Town Center | $10,000 | 0 | 1,135 | 1,135 |
| Tigard | Town Center | $10,000 | 67 | 337 | 404 |

**Table 6: Subsidized housing costs by district**

| | Subsidy per unit | Units | Total Subsidy |
|---|---|---|---|
| Central Eastside | $50,000 | 1,196 | $59,800,000 |
| Downtown Waterfront | $50,000 | 3,376 | $168,800,000 |
| North Macadam | $50,000 | 10,574 | $528,700,000 |
| Oregon Convention Center | $50,000 | 7,105 | $355,250,000 |
| River District | $50,000 | 5,336 | $266,800,000 |
| South Park Blocks | $50,000 | 787 | $39,350,000 |
| Gateway Regional Center | $25,000 | 4,233 | $105,825,000 |
| Lents Town Center | $10,000 | 17,891 | $178,910,000 |
| Education URA | $10,000 | 831 | $8,310,000 |
| Interstate Corridor | $50,000 | 19,230 | $961,500,000 |
| Neighborhood Prosperity Initiative | $10,000 | 6,676 | $66,760,000 |
| Transit-Oriented Development | $10,000 | 4,418 | $44,180,000 |
| Clackamas | $25,000 | 248 | $6,200,000 |
| Gresham | $25,000 | 379 | $9,475,000 |
| Hillsboro | $25,000 | 646 | $16,150,000 |
| Oregon City | $25,000 | 886 | $22,150,000 |
| Tanasbourne/Amber Glen | $25,000 | 1,561 | $39,025,000 |
| Gladstone | $10,000 | 10 | $100,000 |
| Lake Oswego | $10,000 | 36 | $360,000 |
| Rockwood | $10,000 | 1,135 | $11,350,000 |
| Tigard | $10,000 | 404 | $4,040,000 |
| | | | $2,893,035,000 |

## METRO'S URBAN GROWTH REPORT AND THE IMPACT ON THE ENVIRONMENT

Oregon's system of land use planning and its urban growth boundaries were established on a model of environmental protection. Resource lands for agriculture and forestry were seen as vulnerable to urban development. Every urbanized area within the state was required to establish an urban growth boundary, and property subdivision and housing production in rural areas was greatly constrained. As the urban economy within the state has expanded, the system of UGBs has created substantial differentials in land prices inside the UGB and outside the UGB, perhaps on a factor of 10. In more recent years, the justification for the land use planning system has morphed to include the idea of reduced public infrastructure costs, the value of open space, and the benefits to global warming from more compact development.

In 2009, the state legislature commissioned Metro to conduct a "Climate Smart Communities Scenario Project" to explore ways to reduce carbon emissions in the region. Unfortunately, rather than taking a direct approach to the problem of carbon emission, such as a carbon tax, Metro has proposed indirect approach, which coincides with many of the policy assumptions in the 2014 Draft Urban Growth Report, including encouraging higher density compact development, promoting mass transit, and encouraging mixed-use development. A Metro Council decision on the Climate Smart Communities Scenario Project will occur two weeks after the Metro Council decision on the Urban Growth Report, so that impact of the Urban Growth Report on climate change should be assessed carefully.

What should be clear from the above discussion about the changes in transportation behavior and mode share in the Urban Growth Report is that Metro's statements about outcomes in 2035 are largely aspirational, rather than a forecast or a financial plan. The Climate Smart Communities Scenario Project discusses in more detail some plans to achieve the transportation behavior changes, but most of the tools discussed are largely more intensive versions of existing policy: increasing funding of mass transit, support for more dense urban development, better bike paths and sidewalks, development of safer streets and highways, etc. Nothing in this plan or in Metro's Urban Growth Report point to the Portland region attaining the non-automobile commuting share of the New York metropolitan region. This suggests that there is no justification for the transportation cost benefits promised in the Draft Urban Growth Report.

What is certain about Metro's Urban Growth Report is that real estate development will become more difficult and housing costs in the region will rise. And we can be certain that this will lead economic growth to move outside the region.

In a recent study of carbon emissions across US metropolitan areas, Harvard economist Edward Glaeser and UCLA economist Matthew Kahn found that carbon emissions tend to be lower in cities rather than suburbs, lower in new houses compared to older homes, and in lower western states such as California and Oregon, compared to Southern states such as Texas and Georgia (where cooling costs are high) or Northern states such as Illinois or Pennsylvania (where heating costs are high). After factoring in the source of fuel in each region and an estimated $43 of damage for each ton carbon emitted, they came up with the following estimate of the carbon emission cost per household. The table has been edited to emphasize larger metro areas and Western metro areas.

**Table 7: Annual carbon emissions cost, per household, by metropolitan area**

| Metropolitan area | Average New House | Average House | Average/ New Difference | City/ Suburban Difference |
|---|---|---|---|---|
| Los Angeles | $840 | $1,188 | $348 | -$45 |
| San Diego | $844 | $1,148 | $304 | na |
| San Francisco | $858 | $1,152 | $294 | $173 |
| Sacramento | $913 | $1,237 | $324 | $85 |
| Phoenix | $983 | $1,307 | $324 | $84 |
| Denver | $1,037 | $1,336 | $299 | na |
| Portland | $1,044 | $1,347 | $303 | $128 |
| New York | $1,062 | $1,379 | $317 | $289 |
| Salt Lake City | $1,100 | $1,406 | $306 | na |
| Boston | $1,123 | $1,253 | $130 | $256 |
| Seattle | $1,177 | $1,477 | $300 | $105 |
| Miami | $1,203 | $1,768 | $565 | na |
| Chicago | $1,243 | $1,781 | $538 | na |
| Minneapolis | $1,264 | $1,866 | $602 | $171 |
| St. Louis | $1,282 | $1,737 | $455 | $92 |
| Cleveland | $1,309 | $1,633 | $324 | $111 |
| Detroit | $1,313 | $1,862 | $549 | -$77 |
| Washington | $1,319 | $1,832 | $513 | $195 |
| Atlanta | $1,338 | $1,866 | $528 | $258 |
| Philadelphia | $1,357 | $1,698 | $341 | $222 |
| Dallas | $1,375 | $1,926 | $551 | $133 |
| Houston | $1,394 | $1,932 | $538 | $164 |

Source: Glaeser and Kahn (2008)

As the table shows, households in Portland emit relatively little carbon compared to most metropolitan areas, largely due to our relatively mild climate and the high percentage of hydropower used to generate electricity. Cities in California and the western United States also tend to have milder climates and use more hydro and less coal than other states. Cities in the South and the Midwest tend to have much higher carbon emissions. Also, new homes tend to have fewer emissions, as they tend to be more energy efficient, offsetting the additional driving typically associated living in a new home, which is shown in column 3. Glaeser and Kahn have also estimated the differences in carbon emission between a typical household in the central city vs. its suburb for most of the metro areas. As a general pattern, city resi-

dents emit less carbon due to their smaller houses and greater use of mass transit. However, that differential is generally smaller than the difference between new and existing homes and between homes in different regions.

Given these patterns, we ought be encouraging new housing development, particularly in Portland and other cities in the western United States as part of a strategy to reduce carbon emissions. Unfortunately, our policies against new development are raising housing prices and steering population growth in the Southeastern and Southwestern United States, where carbon emissions are much higher.

## METRO'S URBAN GROWTH REPORT AND ECONOMIC DEVELOPMENT

This review has focused on the impact of Metro's policies on housing costs. We have found that the Urban Growth Report favors higher density housing development that can only be supported by significantly higher rents and housing prices. While local residents will suffer those burdens in the short run, long run impacts of housing appreciation not warranted by amenity increases will result in less investment and employment in the region. In an amenity-rich region, firms may reduce wages knowing that prospective employees will receive a "second paycheck" in the form of milder climate, better schools, and greater entertainment options. The idea of an amenity advantage has been a big driver in the economic development of the Sunbelt states, as employers are able to experience a lower labor cost structure.

Unfortunately, the housing appreciation anticipated in the Urban Growth Report exceeds any range of possible increase in amenities, causing potential employees to seek wage premiums to move to such a location. This pattern of barriers to development in high amenity areas has steered development to regions in the country more amenable to development. As Edward Glaeser writes regarding growth controls in California:

> While limits on California's growth may make that state seem greener, they're making the country as a whole browner and increasing carbon emissions worldwide. Houston's developers should thank California's anti-growth movement. If they hadn't stopped building in Coastal California, where incomes are high and the climate is sublime, then there wouldn't have been nearly as much demand for living in the less pleasant parts of the Sunbelt.

Thus, the challenge of global warming is to remember that citizens have choices. If we make paradise unaffordable, people will live elsewhere.

The bias in Metro's Urban Growth Report also extends to commercial and industrial development, which has not been a focus of this review. For example, in the acreage assigned for industrial development, Metro has included acres of land that have been assessed as brownfields, substantial acreage on West Hayden Island, and several golf courses near the Portland Airport. In each of these cases, there is a low

chance of development happening in the next 20 years. No funding mechanism for widespread remediation of brownfields exists that supports this assumption. Or put differently, brownfields will only redevelop when property demand is very high to support that development. On West Hayden Island, the City of Portland's Planning and Sustainability Commission adopted an annexation plan that required extension mitigation costs on development, leading the Port of Portland to abandon plans to develop that site. And no one anticipates member-owned golf courses being converted into industrial uses. The compensation cost to the membership would exhaust the value of any potential demand by industrial users. Nevertheless, the assumption that these lands are available for industrial use was kept in the Urban Growth Report, largely to prevent a need to expand the urban growth boundary.

## RETHINKING LAND USE PLANNING POLITICS

This review has questioned many of the assumptions behind Metro's Urban Growth Report and suggests that it will harm the economic vitality of the region and further skew economic benefits from low-income households to high-income households. Metro has developed a plan that increases housing costs, increases commute times, and reduces employment opportunities. The Urban Growth Report isn't internally consistent, and its policy effect will prevent land from being utilized for vital human needs.

What is the alternative? How should we plan for future growth in the region? Those are broad questions, but here are some ideas.

One possibility is that Metroscope needs to become an even more sophisticated regional planning model, so that changes in housing prices affect economic investment, employment, and population growth. Such a modeling effort would require a lot of time and investment, but it would recognize that we live in a region where urban planning can have significant feedback impacts on local economic activity. That might raise an issue of whether we want our region to grow or whether we want our children to move elsewhere, but at least the debate would be clear.

A second option might be to raise the importance of housing costs and human habitat to the level being placed by farmland preservation and a tight urban growth boundary in our regional decision-making. The current formulation has a baseline assumption of a fixed urban growth boundary. The Urban Growth Report tests whether future population growth can fit into that boundary, even with highly unrealistic housing cost impacts. An alternative might be to accept a certain level of housing price appreciation, perhaps a 5% growth after inflation over 20 years, and then find a combination of higher density development and urban growth boundary expansion that fits into that housing cost assumption. Currently, we pay only lip service to housing affordability.

Third, we might increase the priority placed to local housing prices and land prices, which act as a signal to where people want to live. Land prices on the western and southern edge of the metro area tend to be much higher inside the urban

growth boundary than outside. That differential represents an increase in welfare that would come from expanding the boundary in those locations. As we expand on the west side, we could target expansions to avoid particularly high valued forests and farmland, such as the wineries of Yamhill County. Unfortunately, the current system focuses expansion on places on the east side of the region, which is the least attractive to housing consumers. In fact, much of the land in the Damascus area could be taken out of the UGB and replaced by land elsewhere at enormous benefit to the public. Using prices as a guide, UGB expansions could be determined in a decentralized way by underlying consumer choice, rather than in a regional planning model or by log-rolling politics.

Finally, our planning system needs to address the problems of road construction and infrastructure development seriously, rather than assume a wholesale shift to non-automobile commuting. While visitors marvel at the light rail construction in our region, that experiment has failed to change the percentage of transit commuters and our highways are as congested as ever. We obviously need smarter highways to smooth out demand between rush hour and off-peak driving and give more incentives to choose alternatives. Tools like congestion pricing can be used to selectively add capacity, as our leaders were prepared to do with the Columbia River Crossing, and create incentives for alternative modes. And we will benefit from a new generation of cleaner cars, so that the impact of accommodating the public's preference for driving themselves doesn't have to come at a cost to air quality. However, we shouldn't base our land use planning decisions on commuting assumptions that won't happen.

The Metro Council may adopt the draft Urban Growth Report in December, despite the criticisms presented here. However, it's also possible that the state legislature, less beholden to the special interests at Metro headquarters, will repeat the grand bargain of last March and perform another end-run around the Metro decision-making process. It's important for legislators in other parts of the state to recognize that economic development is not a zero-sum game. Economic growth in Portland brings trade and investment across the entire state and region, represented by suppliers of building materials, Willamette Valley farms, Oregon coast fisheries, or tourist destinations in the Cascades or Eastern Oregon. Whether Oregon can escape the California disease of anti-growth policies should be of concern to everyone. ■

# THE STATE OF THE ECONOMY

CARLY HARRISON

Portland State University

The economy continues to grow at a steady rate, with slight increases in global and national GDP, a lower national unemployment rate, and modest inflation.

In the third quarter, the United States output grew at a seasonally adjusted annualized growth rate of 3.5 percent, unemployment dropped to 5.9 percent, a record low since 2008, job growth was higher in September than the previous 12 month average, and the stock market had overall strong growth. And lastly, the Federal Reserve ended its latest round of quantitative easing in October, in line with expectations.

## THE WORLD ECONOMY

The global recovery continues, but remains weak. The International Monetary Fund's October outlook reports that world growth is expected to be lower than previously anticipated, with a downward revision to 3.3 percent for 2014, and 3.8 percent for 2015.

Moving from the past to the future, the task of the global recovery is to balance dealing with the legacies of the financial crisis, such as unemployment and debt,

■ Carly Harrison is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

while focusing on potential growth. As Table 1 shows, advanced economies are showing reasonable growth, led by growth in the United States, but dragged by relatively low growth in Japan and the Euro Area. Many consider the US economy to be in the most balanced growth position relative to the rest of the world. Emerging market economies are showing increased geopolitical risks, lowered potential growth, and a risk of deflation in economies where demand weakens further.

With the increased risks in both advanced economies and emerging markets, the IMF states that raising actual and potential growth must remain a priority. In advanced economies, this will require continued support from monetary policy and fiscal adjustment, such as public infrastructure investment, while emerging economies, macroeconomic policies are need to support general growth.

**Table 1: Selected Advanced Economies: Real GDP, Consumer Prices, Current Account Balance, and Unemployment (Annual percent change unless noted otherwise)**

| | Real GDP | | | Consumer Prices[1] | | | Current Account Balance[2] | | | Unemployment[3] | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Projections | | | Projections | | | Projections | | | Projections | |
| | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 | 2013 | 2014 | 2015 |
| **Advanced Economies** | **1.4** | **1.8** | **2.3** | **1.4** | **1.6** | **1.8** | **0.4** | **0.3** | **0.2** | **7.9** | **7.3** | **7.1** |
| United States | 2.2 | 2.2 | 3.1 | 1.5 | 2.0 | 2.1 | –2.4 | –2.5 | –2.6 | 7.4 | 6.3 | 5.9 |
| Euro Area[4,5] | –0.4 | 0.8 | 1.3 | 1.3 | 0.5 | 0.9 | 2.4 | 2.0 | 1.9 | 11.9 | 11.6 | 11.2 |
| Japan | 1.5 | 0.9 | 0.8 | 0.4 | 2.7 | 2.0 | 0.7 | 1.0 | 1.1 | 4.0 | 3.7 | 3.8 |
| United Kingdom[4] | 1.7 | 3.2 | 2.7 | 2.6 | 1.6 | 1.8 | –4.5 | –4.2 | –3.8 | 7.6 | 6.3 | 5.8 |
| Canada | 2.0 | 2.3 | 2.4 | 1.0 | 1.9 | 2.0 | –3.2 | –2.7 | –2.5 | 7.1 | 7.0 | 6.9 |
| Other Advanced Economies[6] | 2.3 | 2.9 | 3.1 | 1.5 | 1.6 | 2.2 | 5.5 | 5.1 | 4.8 | 4.5 | 4.5 | 4.4 |

Note: Data for some countries are based on fiscal years. Please refer to Table F in the Statistical Appendix for a list of economies with exceptional reporting periods.
[1]Movements in consumer prices are shown as annual averages. Year-end to year-end changes can be found in Table A6 in the Statistical Appendix.
[2]Percent of GDP.
[3]Percent. National definitions of unemployment may differ.
[4]Based on Eurostat's harmonized index of consumer prices.
[5]Current account position corrected for reporting discrepancies in intra-area transactions.
[6]Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.

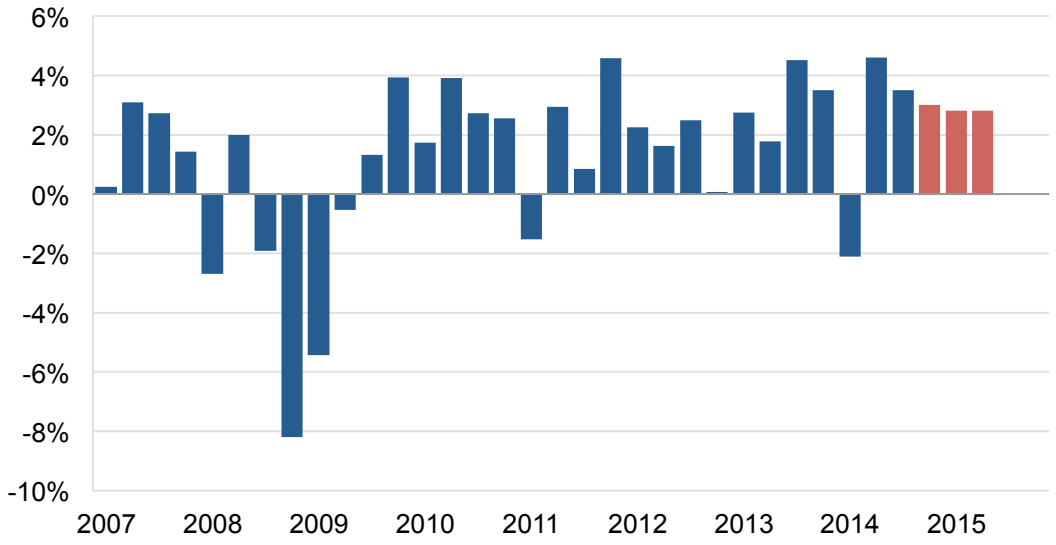
Source: World Economic Outlook, October 2014

## THE UNITED STATES ECONOMY

With a first quarter of negative GDP growth, and a second quarter of positive 4.6 percent growth, the third quarter shows the US economy is continuing to grow. The United States Bureau of Economic Analysis reports an estimated 3.5 percent annualized increase in real GDP (Figure 1). Among other things, this increase reflects positive contributions from personal consumption expenditures, exports, government spending, and nonresidential fixed investment. The deceleration from the second to third quarter reflects a downturn in the above contributions, somewhat countered by a downturn in imports and increase in federal spending.

Unemployment continues to decrease, moving from 6.6 percent at the beginning of 2014, to 5.9 percent in September. This is the first time the unemployment rate has dipped below 6.0 percent since July 2008. September job growth has surpassed the average of the 12 prior months, showing total nonfarm employment rose by 248,000, compared to 213,000. Similarly to June's job growth, September's growth occurred mostly in professional and business services, retail trade, and health care.

**Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2007–2015**



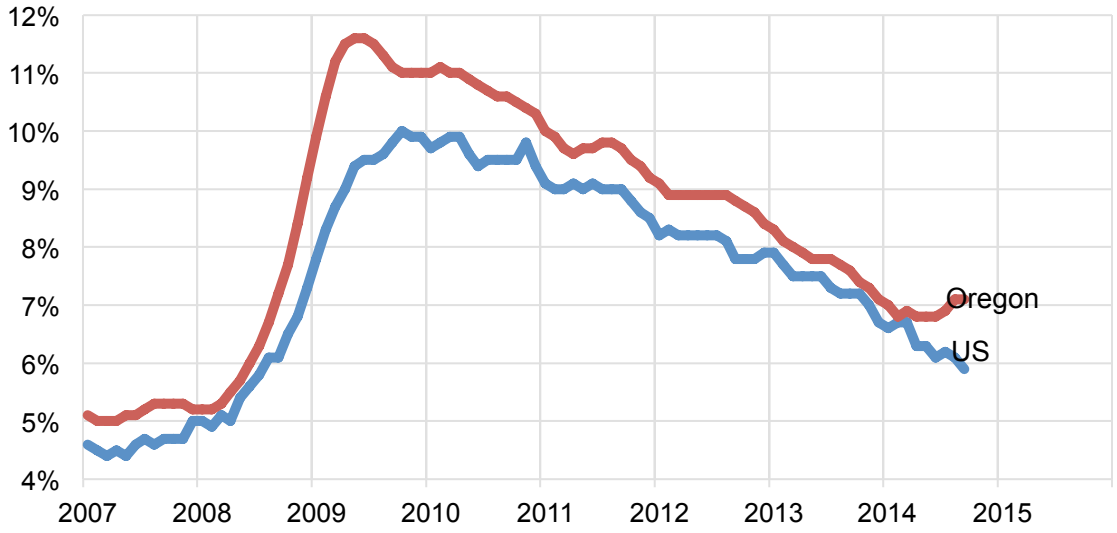

Source: Bureau of Economic Analysis and Wall Street Journal Economic Forecasting Survey

While the unemployment rate has continued to drop nationally (**Error! Reference source not found.**), there still remains some uncertainty regarding the validity of this number, especially since labor force participation has continued to decreased (

**Figure 3**). In the Wall Street Journal, William Galston reminds that the unemployment rate would be nearly twice as high if 2007 participation rates were in place today.

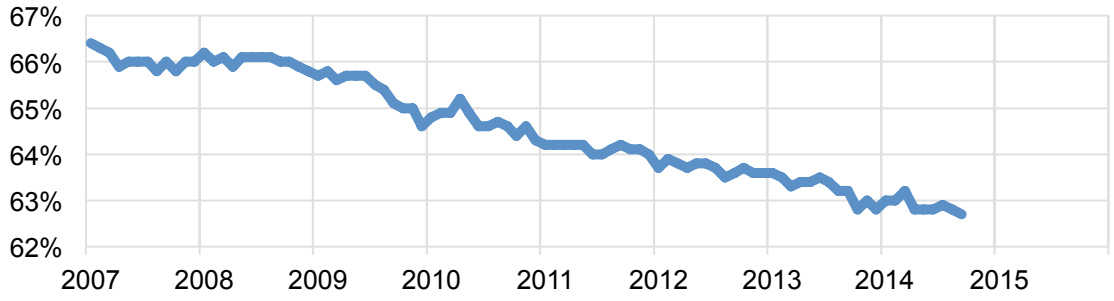
In addition to continued high underemployment, earnings growth has also been weak. Between 1981 and 2014, according to the Bureau of Labor Statistics, wages rose at a rate of 0.3 percent a year (corrected for inflation). Factoring in benefits, such as health care, that have risen at a faster rate than wages, this brings the effective compensation growth to 0.6 percent a year.

**Figure 2: Unemployment Rate, Oregon and United States, 2007-2015**




Source: Bureau of Labor Statistics

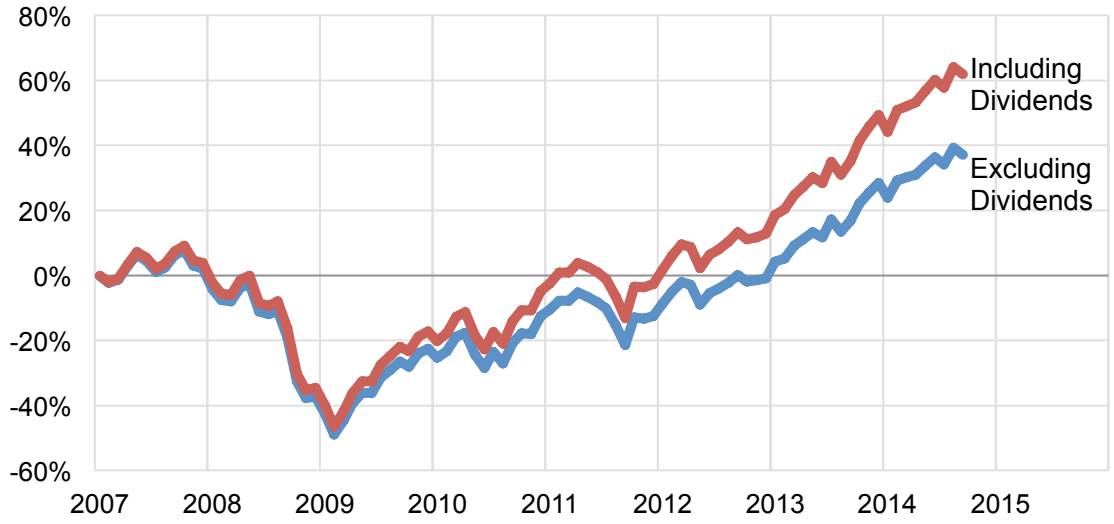
**Figure 3: Labor Force Participation Rate, United States**




Source: Bureau of Labor Statistics

Inflation continues to be positive, hovering around 1.4 percent, according to the U.S. Department of Commerce and the seasonally adjusted Personal Consumption Expenditure index. This is below the Federal Reserve's 2 percent target, and many fear that it may be falling again, causing some to worry about deflation. Some of the concern comes from the limited tools by the Federal Reserve to counter deflation, since interest rates are already as low as they can be. In the face of inflation, tightened policy is a relatively simple response, but deflation can also be a challenge, especially since the Federal Reserve's Quantitative Easing has been discontinued.

**Figure 4: Standard & Poor's 500 Index, 2007–2014**

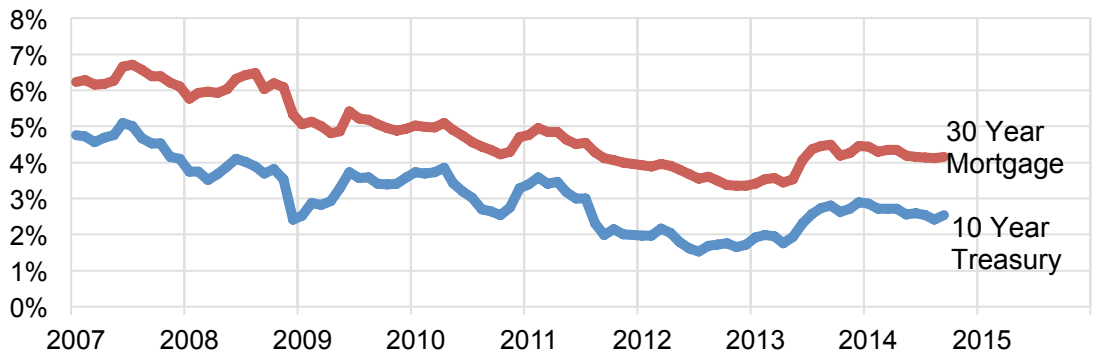



Source: S&P Dow Jones Indices, McGraw Hill Financial

The U.S Stock Market continued to grow after the second quarter (Figure 4), until descending in October due to a sharp decline in oil prices and deterioration in European economic growth. According to the Wall Street Journal, this decline has begun to lift, and third-quarter earnings are showing solid growth.

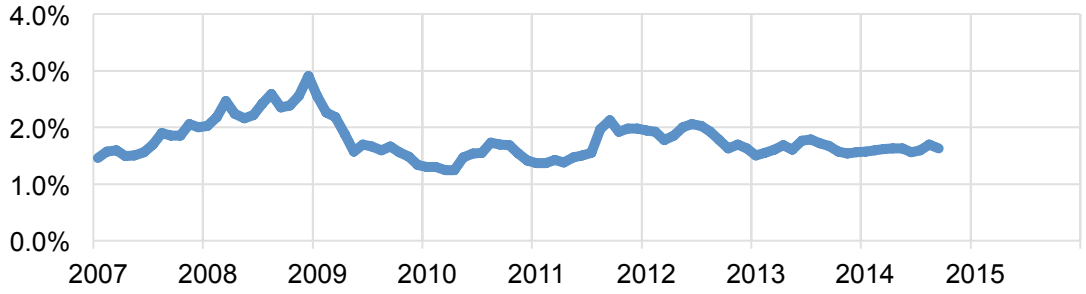
As was expected, on October 29, the Federal Reserve announced the end of its quantitative easing program. It will not be ending the policy for good, however. While there are mixed opinions of its merit, and some uncertain long-term effects on financial markets and the economy, at this point it will remain a tool for worst-case scenarios, once other tools are exhausted. As indicated in Figure 5 and Figure 6, the spread between 10 Year U.S. Treasuries and 30-Year Mortgages remains around 1.6 percent.

**Figure 5: 10 Year U.S. Treasuries vs. Conventional 30-Year Mortgages, 2007–2014**




Source: Federal Reserve Bank

**Figure 6: Spread Between 10 Year U.S. Treasuries and Conventional 30-Year Mortgages, 2007–2014**

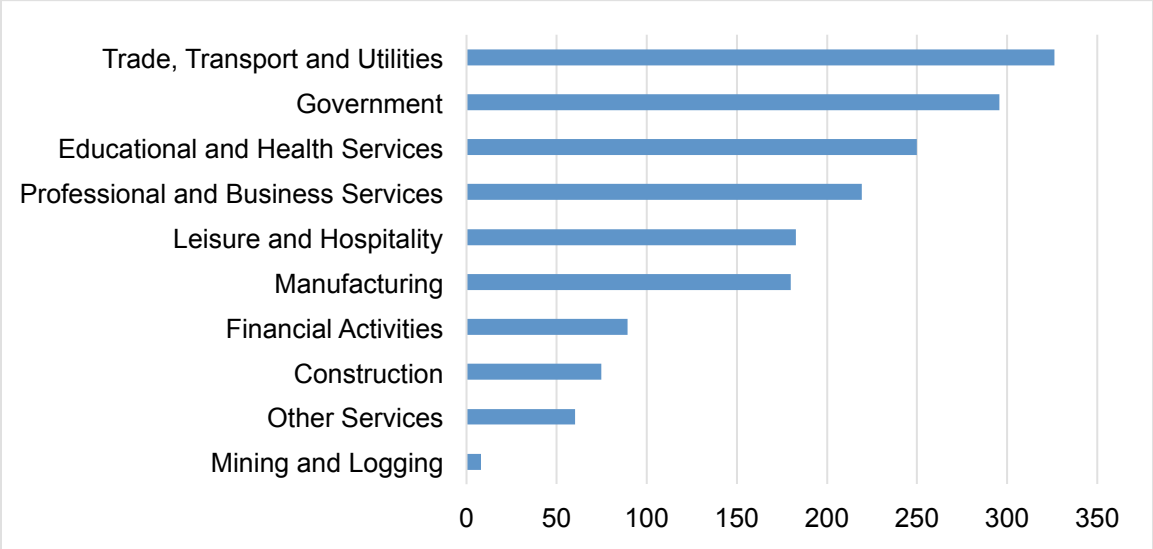



Source: Federal Reserve Bank

## OREGON AND THE PORTLAND AREA

The state of Oregon has continued to show improvement and even acceleration in its economic and labor market recoveries, according to the Oregon Office of Economic Analysis. Over the past year and a half, job growth has accelerated to between 2.5 percent and 3.0 percent. Relative to the peak, the sectors that have shown the most percentage growth are food processing, education, and health, and in the last year, are mining and logging, professional and business services, and leisure and hospitality (Figure 7). In terms of absolute numbers however, the strongest growth has come from professional and business services, trade, transport and utilities, and educational and health services, followed closely by government.

**Figure 7: September Oregon Job Growth, Prior Year Comparison, Nonfarm Payroll Employment, Seasonally Adjusted (1,000's)**



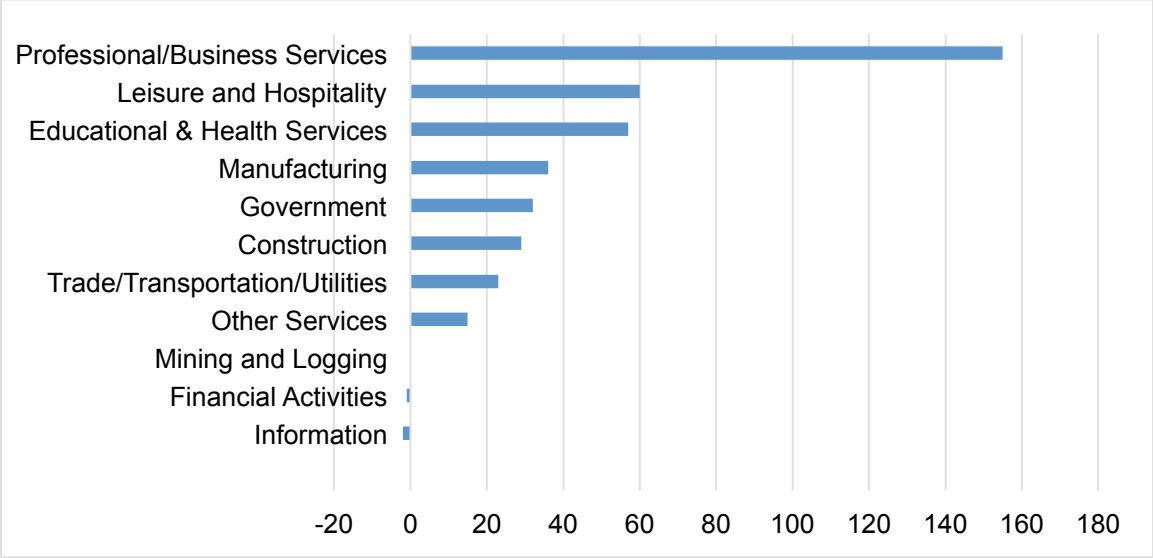

Source: Oregon Employment Department

Another good sign is that in the past nine months, the labor force has increased by more than 15,000 workers, which does have an upward pressure on the state's unemployment rate, which rests at 7.1 percent. This is slight increase from a 2014 average to-date of 6.9 percent. However, the OEA reports that a majority of Oregon's unemployed are new entrants or job leavers, as opposed to those who have lost their jobs, a first since 2007.

In comparing the different geographic economies in Oregon, the two regional economies that have fully regained their recessionary job losses are the Columbia Gorge and the Portland metropolitan area. Job growth has returned to full force in Bend, Eugene and Salem, which had been previously lagging. However, outside the state's metro areas, job growth is slower, with jobs being added at a 1.0 percent rate.

As of August, the Portland-Vancouver-Hillsboro MSA showed 12-month job growth of 2.7 percent, compared to a national growth rate of 1.9 percent. The sectors with the highest growth rate (Figure 8) in the last year are Professional Services (+15,500), Leisure and Hospitality (+6,000), and Construction (+2,900). In terms of absolute growth, Manufacturing (+3,600) and Government (+3,200) have also added many jobs in the last 12 months.

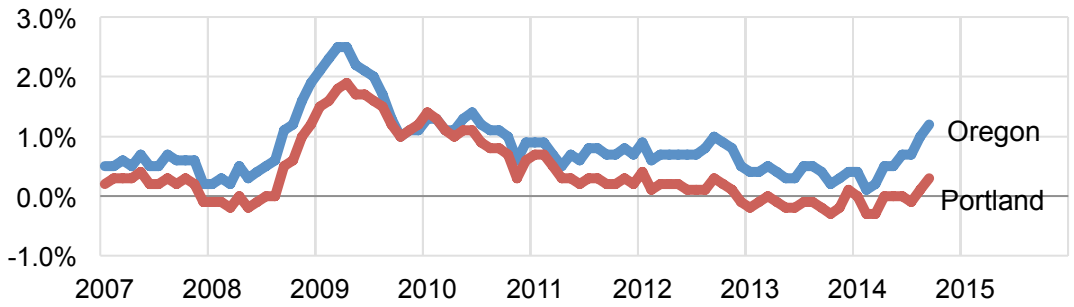
**Figure 8: Portland-Vancouver-Hillsboro MSA, Nonfarm Payroll Employment Growth in Last Year, Not Seasonally Adjusted (100's)**




Source: Oregon Employment Department

Portland's unemployment rate at 6.2 percent (Figure 9) has risen slightly in the last few months, and is currently above the national rate. However, when comparing Portland's un(der)employed with those in other cities, the demographics might be vastly different. According to a recent New York Times article, "Portland has more highly educated people than it knows what to do with," creating a "buyer's market for labor." Unlike many cities who struggle to attract and retain young college-educated people, Portland State University professors say that Portland attracts them at the second-highest rate in the nation.

**Figure 9: Unemployment Rate, Oregon and Portland Metropolitan Area vs. United States**




Source: Bureau of Labor Statistics and Oregon Employment Department

While this is great for Portland, this discrepancy between talent supply and demand hints to a potentially deeper problem. Across the United States, job opportunities continue to increase for high-skill technical workers, leaving mid-skill workers displaced and having to compete with lower-skill workers, further "opening up a great divide between a skilled and wealthy few and the rest of society," in the words of The Economist's economics correspondent Ryan Avent. With Portland's large stock of overeducated and underemployed talent, we could also run the risk of such a divide, if there is not evidence that it already has.

In looking to the future, the big question is whether the Portland immigrants will stay. The economic opportunities are limited. Aaron Renn, an urban affairs analyst for Urbanophile blog, cites the personal income per capita in Portland grew by only 31 percent between 2000 and 2012, slower than 42 other cities. So with forced underemployment and "semiretirement" as the New York Times calls it, economic forces could eventually force them out, especially if cost of living continues to increase.

## CONCLUSION

Overall, the national and local economy is maintaining a steady rate of growth, though there are some risks on the horizon. The outlook calls for continued increase in GDP, a relatively constant unemployment rate and labor force participation rate, and interest rates remain low. Looking to future, the economy is expected to continue to grow, but at somewhat slower rates than the economy has experienced in the past. ■

# RESIDENTIAL MARKET ANALYSIS

SCOTT HOLDEN

RMLS Student Fellow
Master of Real Estate Development Graduate Student

The Oregon/SW Washington markets continue to show strength across the board. The median house price continues to rise and the third quarter was on par with any quarter since the great recession.

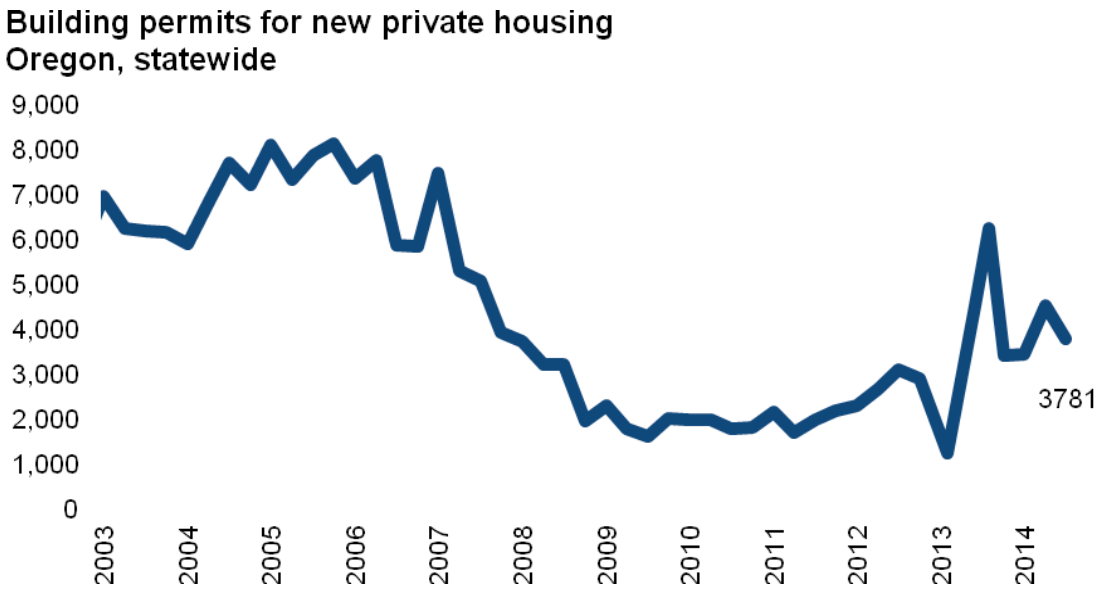
Lurking on the horizon, however, is a significant amount of potential REO and distressed properties. When the Oregon state legislature made it more difficult for lenders to foreclose much of our distressed inventory came back off the market. Now it's back. In the third quarter of 2014 distressed and bank owned properties accounted for 8.8 percent of the 13,763 sales in areas covered by RMLS. In the second quarter of 2014 distressed and bank owned properties accounted for 10.8 percent of the $12,797 sales. That is a pretty significant drop and shows the strength of our markets. It does appear that trend won't last, however. Listings of distressed and bank owned real estate grew as a percentage of total listings from the second to third quarters. In the second quarter there were 22,345 new listings in areas covered by the RMLS. Distressed and REO properties accounted for 6.8 percent of those listings. Compare that to the third quarters 7.1 percent of 19,399 listings. The actual number of REO and distressed listings dropped but not nearly as rapidly as

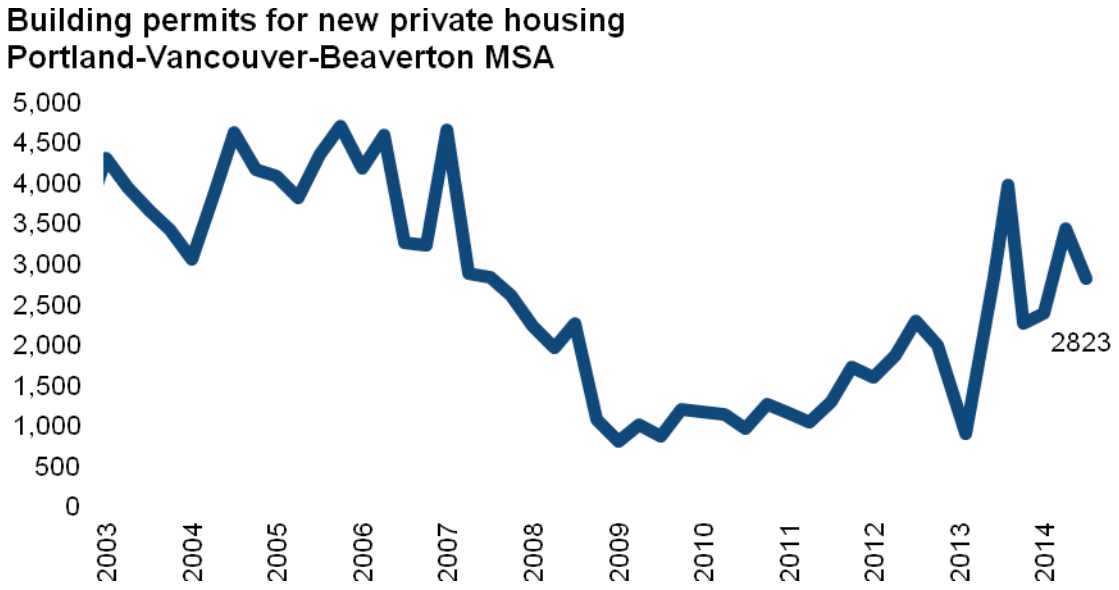
■ Scott Holden is a Senior Relationship Manager at First Republic Bank. He is currently working towards the Master of Real Estate Development degree through a joint program of the School of Business Administration and the School of Urban Studies and Planning where he is an RMLS Student Fellow. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

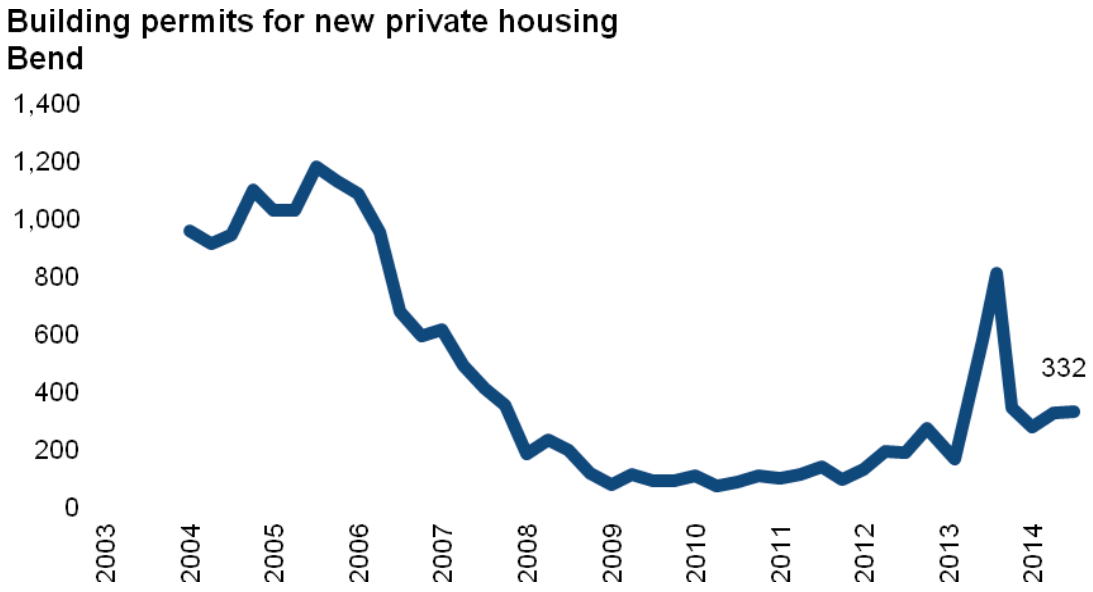
the non-distressed properties. New data released by RealtyTrac suggests that we may see the trend continue. Oregon was one of 22 states where foreclosure auctions spiked in the third quarter. Its 85 percent jump, along with North Carolina's 85 percent, topped the list of those states. Others included New Jersey, Oklahoma and New York. The difference between 2009 and 2014 will be that investors are sitting and waiting to pounce on the potential deals. While the number of REO and distressed properties on the market will increase its possible they will be picked up so fast it will barely show up in median house price data. The next 6 to 12 months could prove to be the buying opportunity investors have been looking for to jump back in.

## BUILDING PERMITS

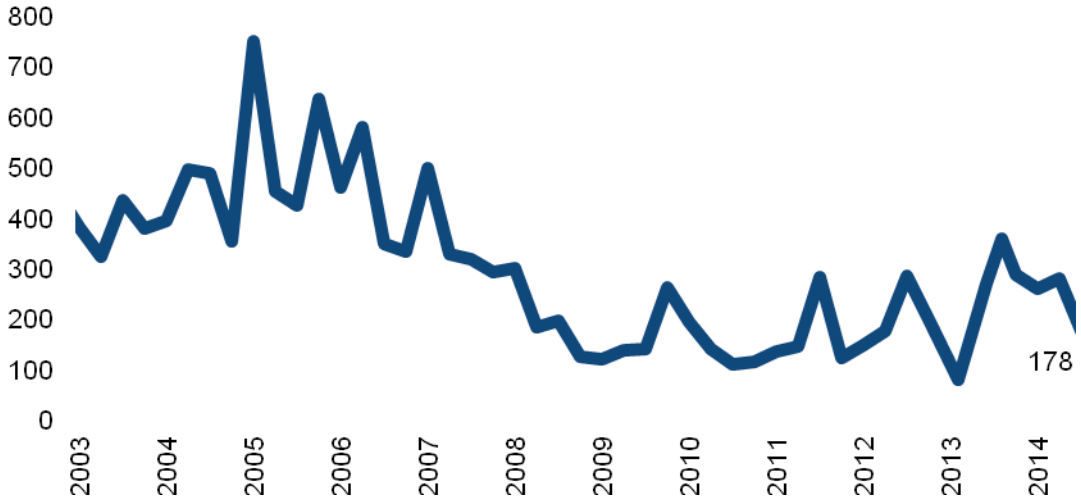
Single family building permits were down 18 percent from the second quarter and 29 percent from the third quarter of 2013. Eugene also declined from 360 permits in the third quarter of 2013 to 178 in the third quarter of 2014. That's a 51 percent drop from 2013 and a 36 percent drop from the second quarter of 2014. Both Bend and Medford stayed steady with the second quarter while dropping significantly from the third quarter of 2013. The state as a whole dropped 2469 units compared to the third quarter 2013 to 3781 units in the third quarter of 2014, a 40 percent drop. We'll be looking to the second quarter of 2015 to determine if the drop is a trend or just an anomaly.



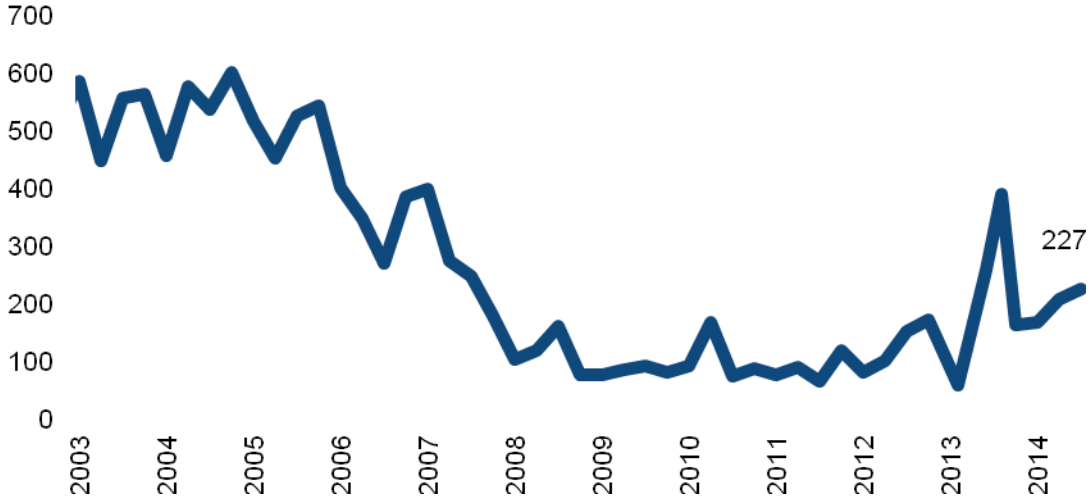

Building permits for new private housing
Portland-Vancouver-Beaverton MSA
5,000
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2823


Building permits for new private housing
Bend
1,400
1,200
1,000
800
600
400
200
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
332

**Building permits for new private housing**
**Eugene-Springfield**



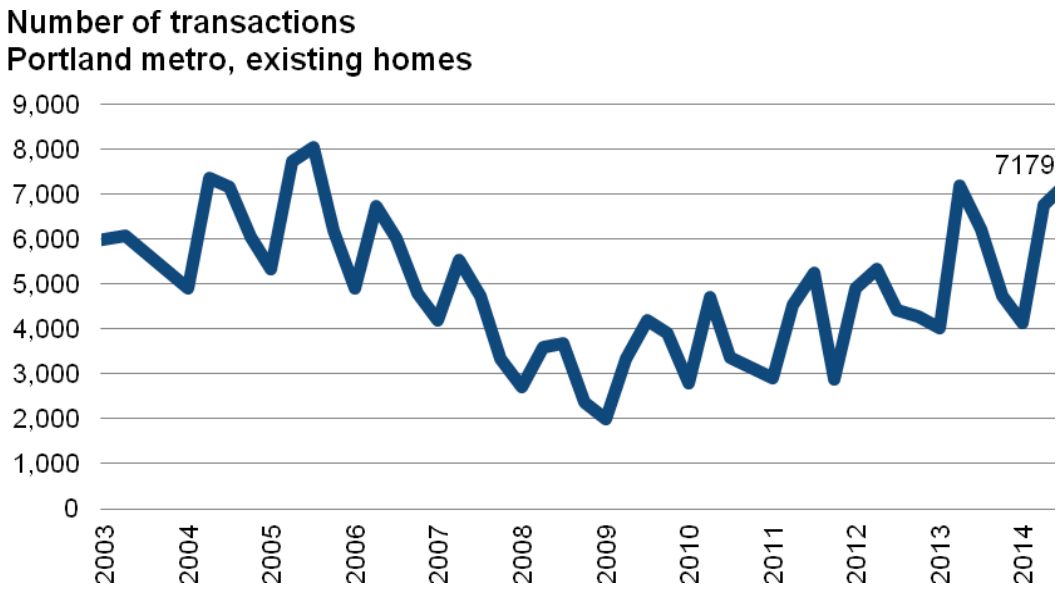

**Building permits for new private housing**
**Medford**



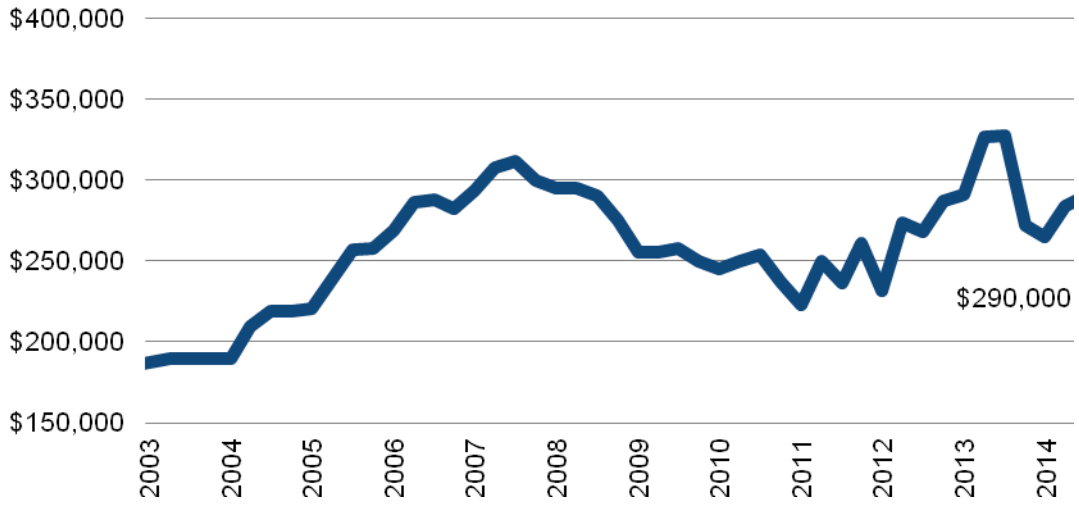
## PORTLAND

The Portland market was up again in the third quarter. Existing home transactions were up 400 units over the second quarter and posted the best quarter since the second quarter of 2013. The median sales price increased $6,000 to $290,000 from second to third quarters and sellers are obtaining 99 percent of the listed price. While marketing time has decreased to 43 days, inventory was up slightly to a 3.1 months' supply

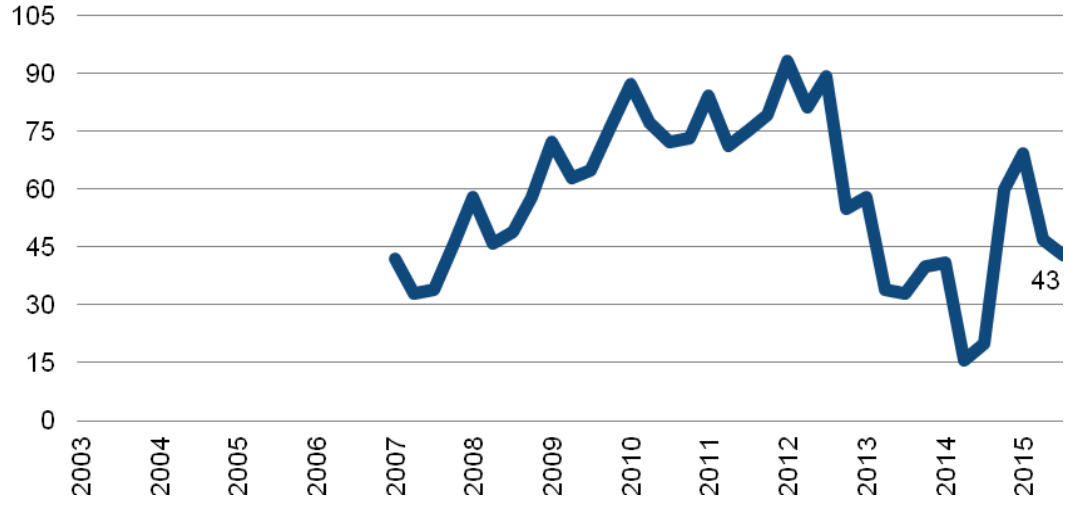
New construction remained relatively flat in the third quarter at 603 transactions and a median price of $359,000.



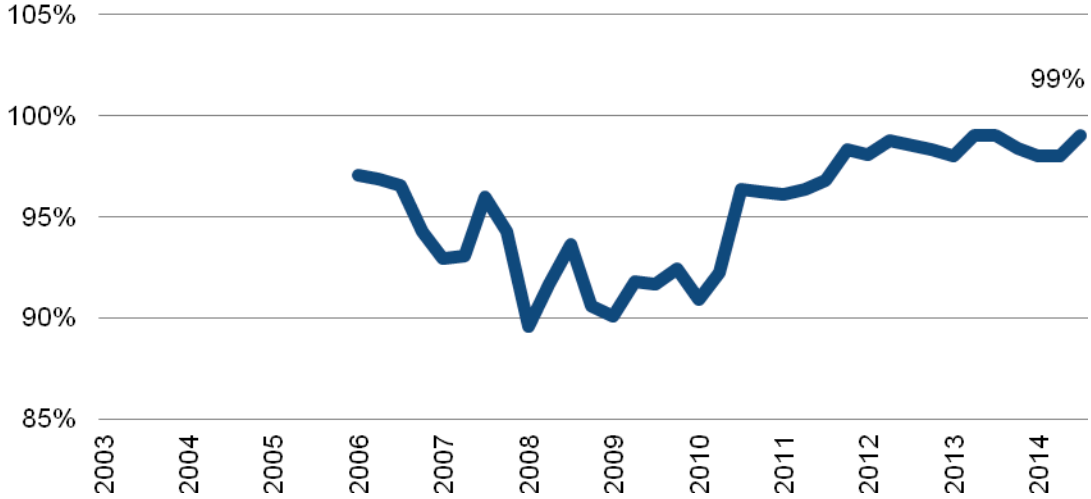
**Median sales price**
**Portland metro, existing homes**



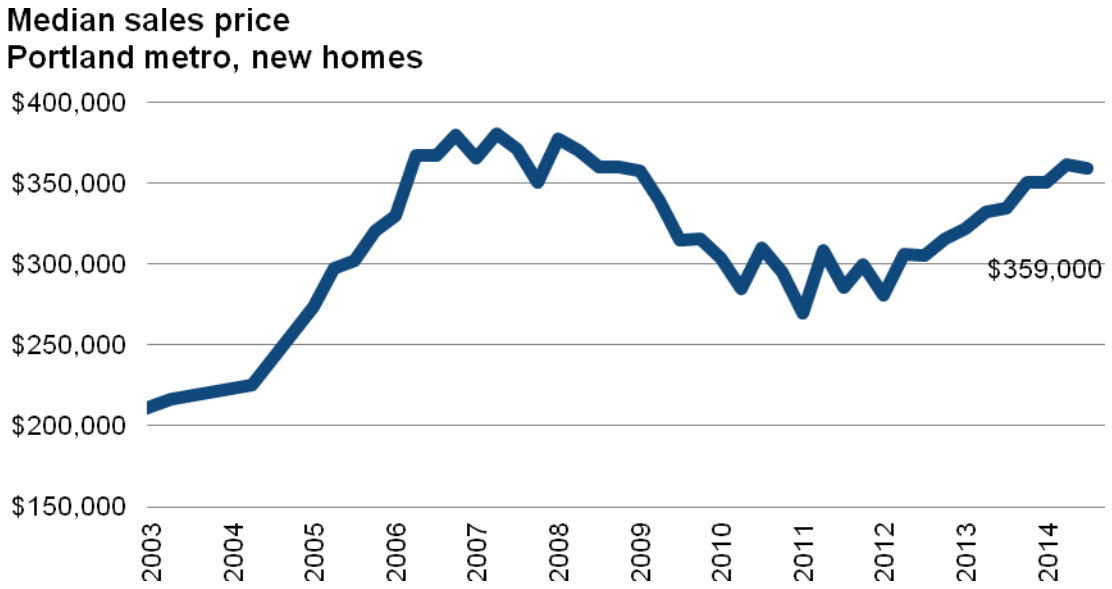

**Days on market**
**Portland metro, existing homes**



**Ratio of sales price to list price**
**Portland metro, existing homes**



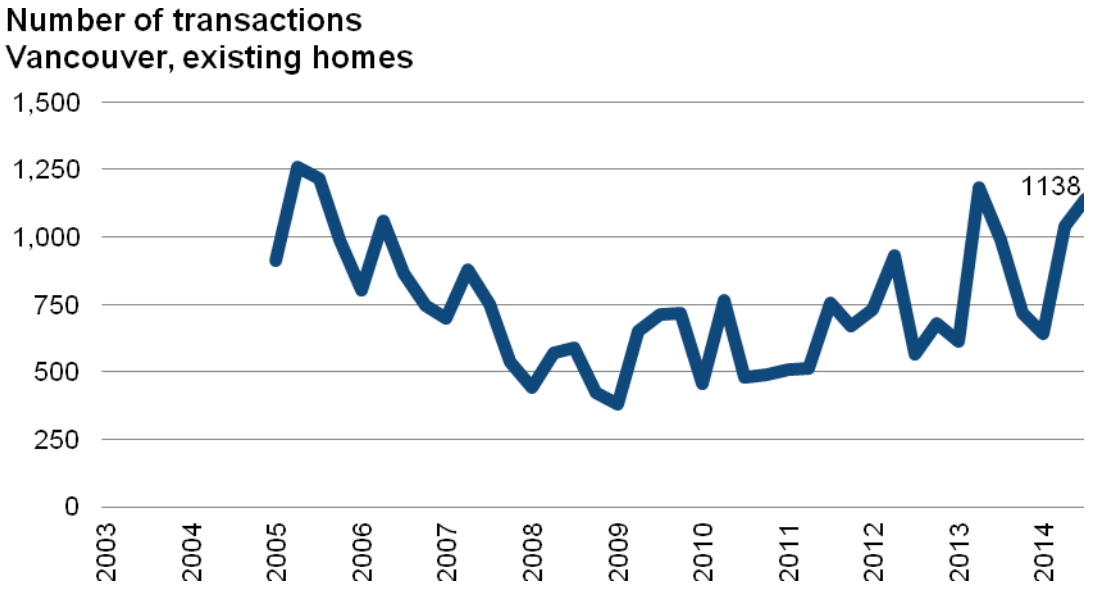

**Number of transactions**
**Portland metro, new detached homes**

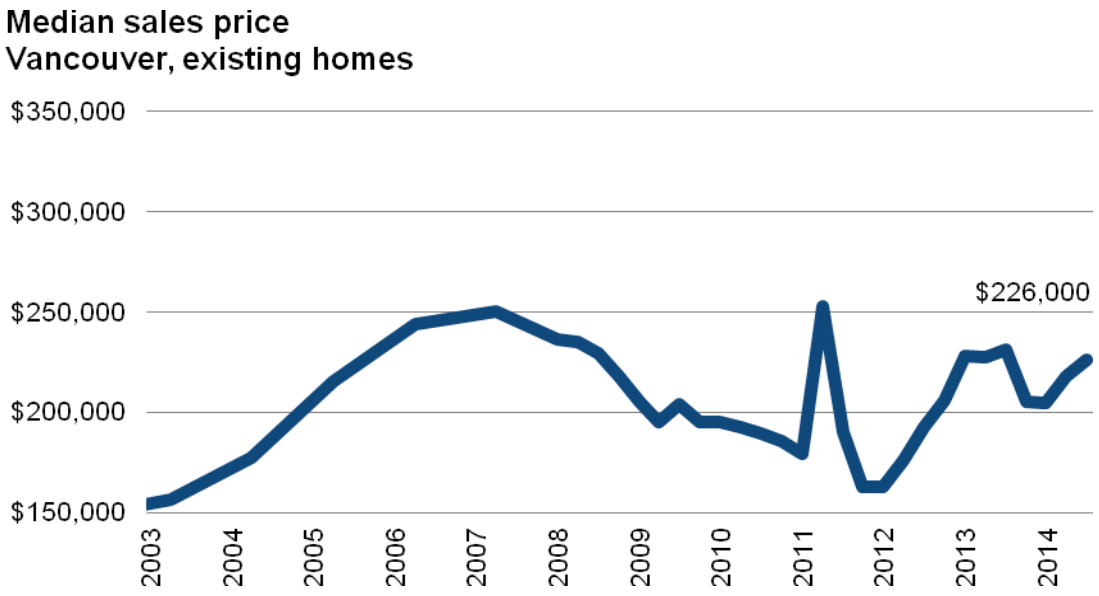


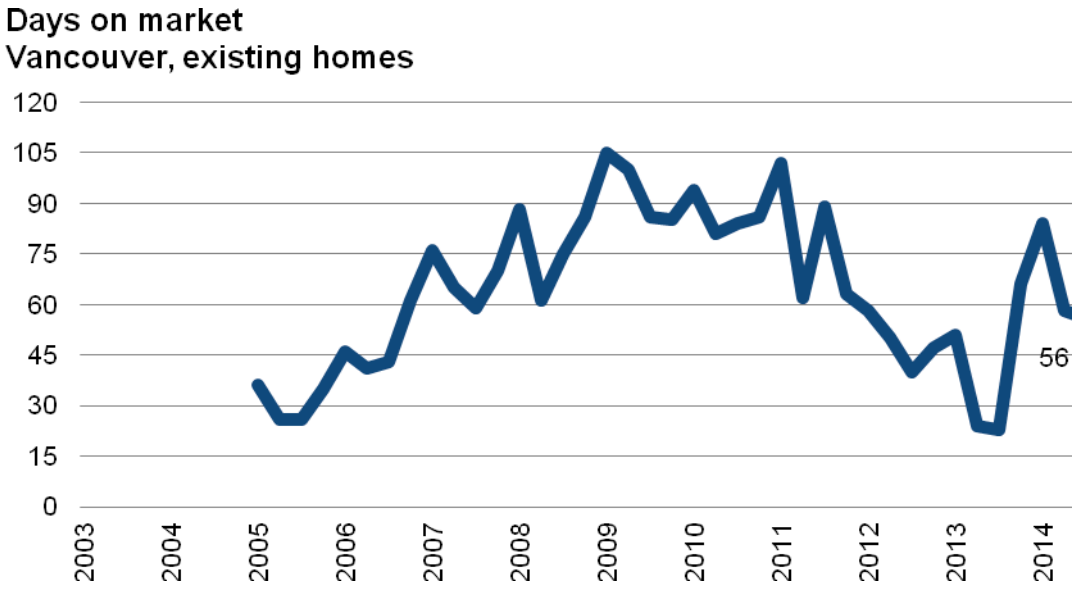

## VANCOUVER/CLARK COUNTY

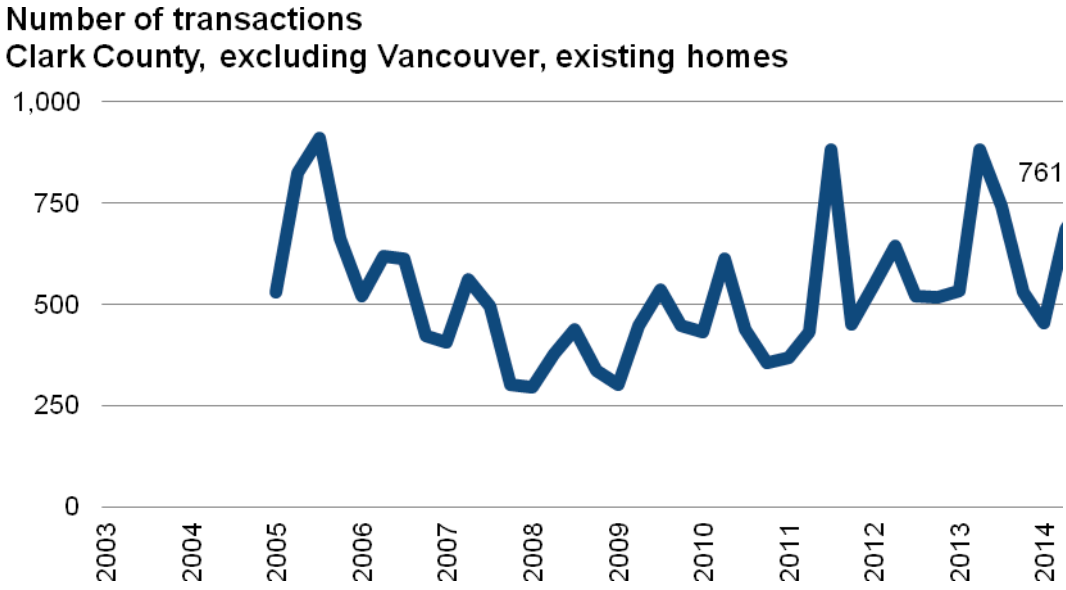
Vancouver showed continued improvement in the third quarter with the number of transactions rising by 98 units and the median price rising from $218,000 in the second quarter to $226,000 in the third. Average marketing time dropped 2 days to 56 days.

Clark County excluding Vancouver showed better strength overall than Vancouver alone with the number rising 10 percent over the second quarter to 761 and the median price 7 percent to $274,000. Average marketing time dropped form 83 days in the second quarter to 68 days in the third. That is a 28 percent drop in marketing time from the first quarter's average of 94 days.

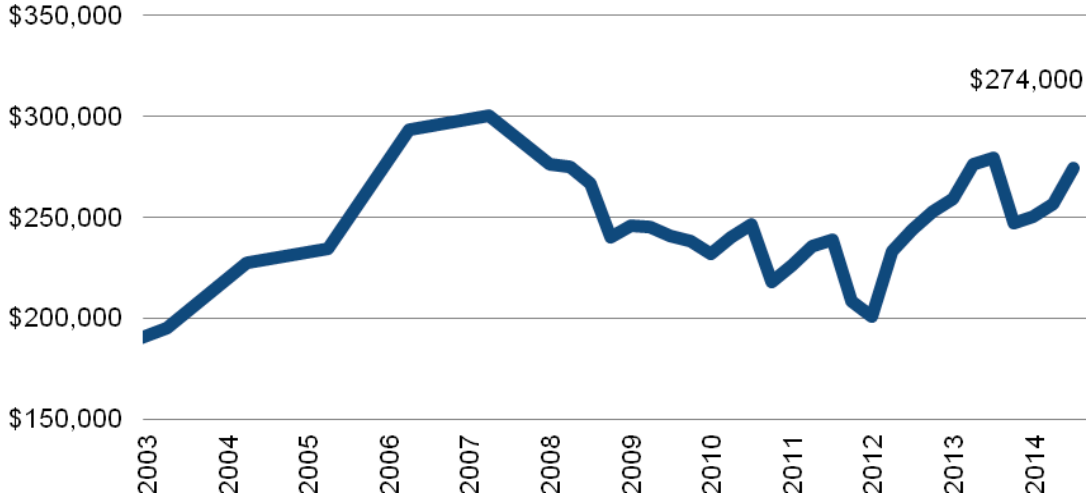

Number of transactions
Vancouver, existing homes
1,500
1,250
1,000
750
500
250
0
1138
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Median sales price
Vancouver, existing homes
$350,000
$300,000
$250,000
$200,000
$150,000
$226,000
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

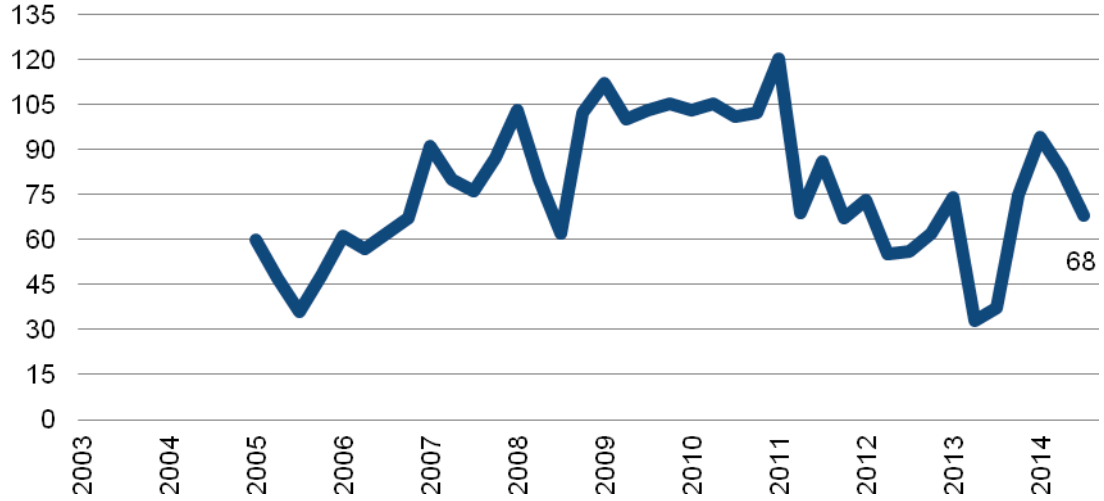

Days on market
Vancouver, existing homes
120
105
90
75
60
45
30
15
0
56
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Number of transactions
Clark County, excluding Vancouver, existing homes
1,000
750
500
250
0
761
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

**Median sales price**
**Clark County, excluding Vancouver, existing homes**



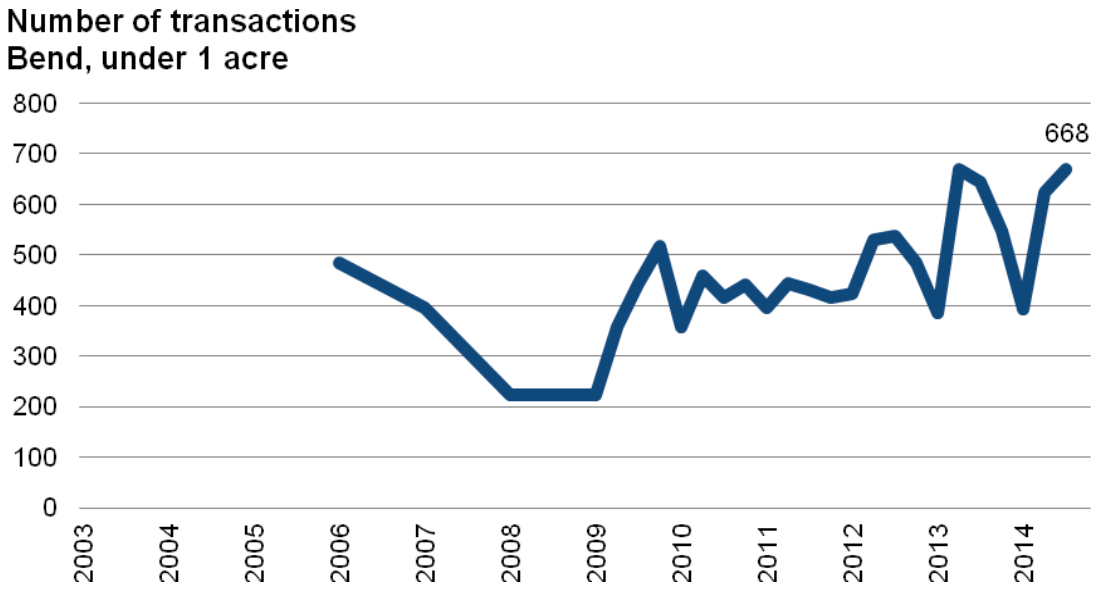

**Days on market**
**Clark County, excluding Vancouver, existing homes**



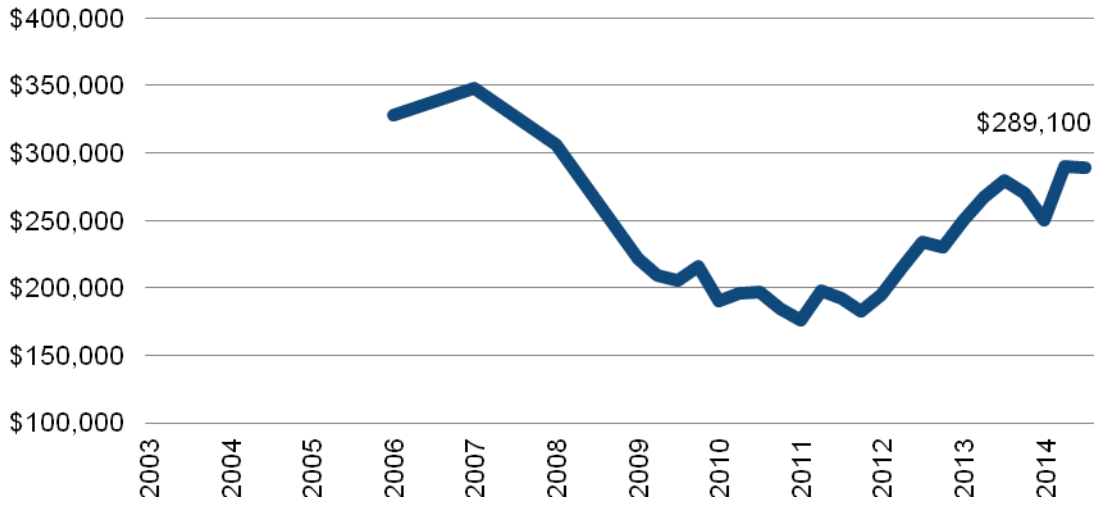
## CENTRAL OREGON

With the exception of the first quarter of 2014 Bend has had steady sales for the last 6 quarters. There were 668 transaction under 1 acre in the third quarter of 2014. This is up from 624 in the second quarter. The median sales price held steady at $289,100.

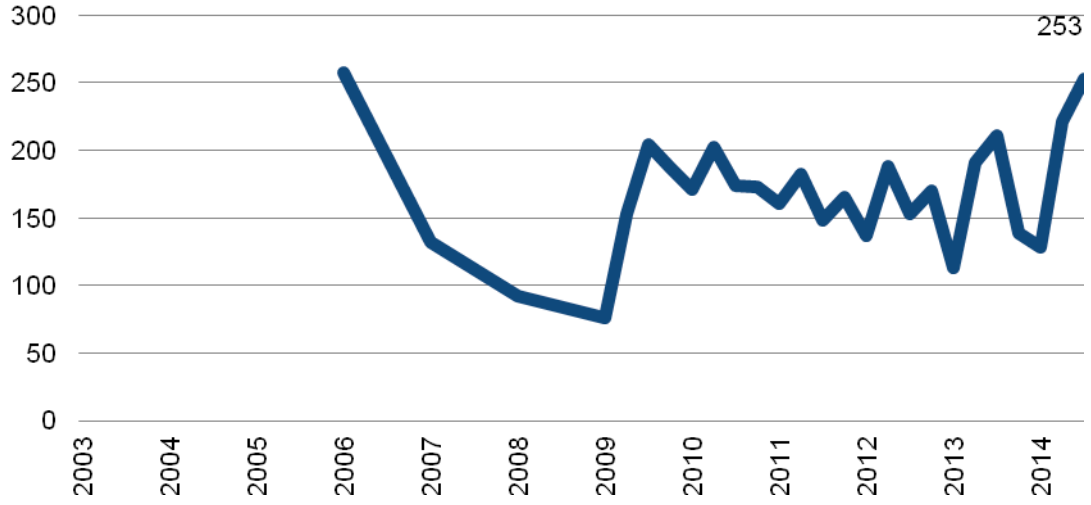
Redmond continued on last quarter's strong growth and posted 253 transactions under 1 acre and the median price rose to $197,000. This is a 20 percent increase in transactions over the third quarter of 2013 and a 10 percent increase in median price over the same period last year. It appears that the growth of Bend is spilling over to Redmond as it has done in previous cycles.

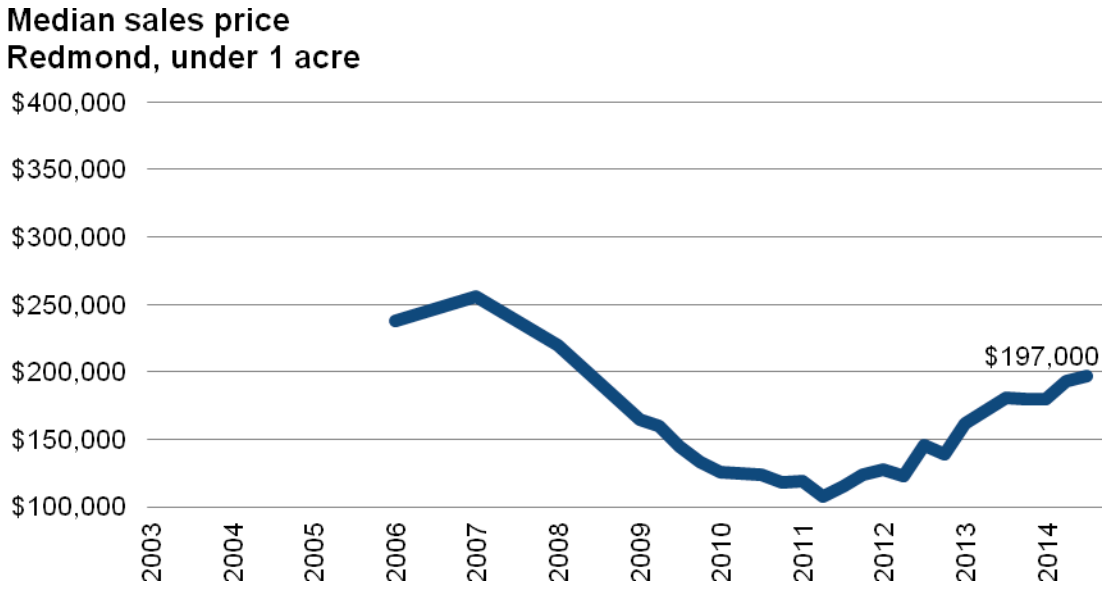


**Median sales price**
**Bend, under 1 acre**



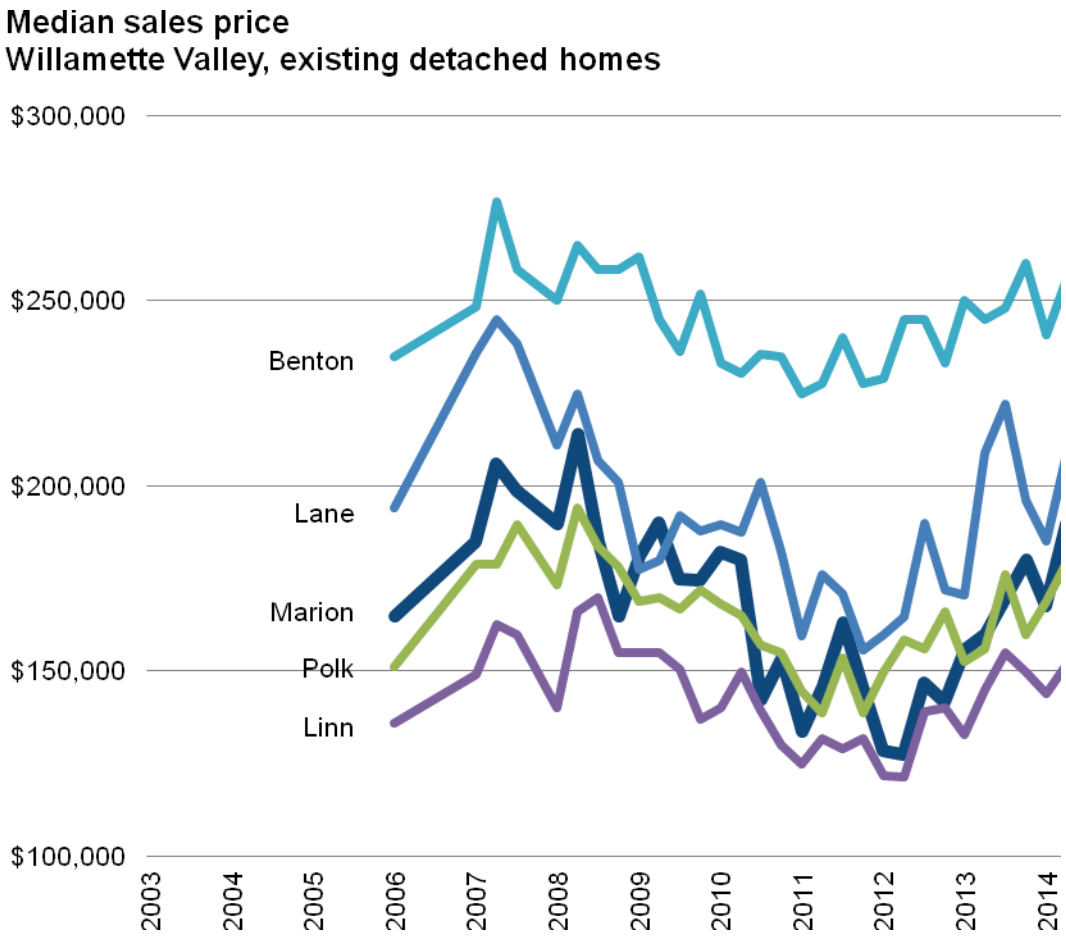

**Number of transactions**
**Redmond, under 1 acre**





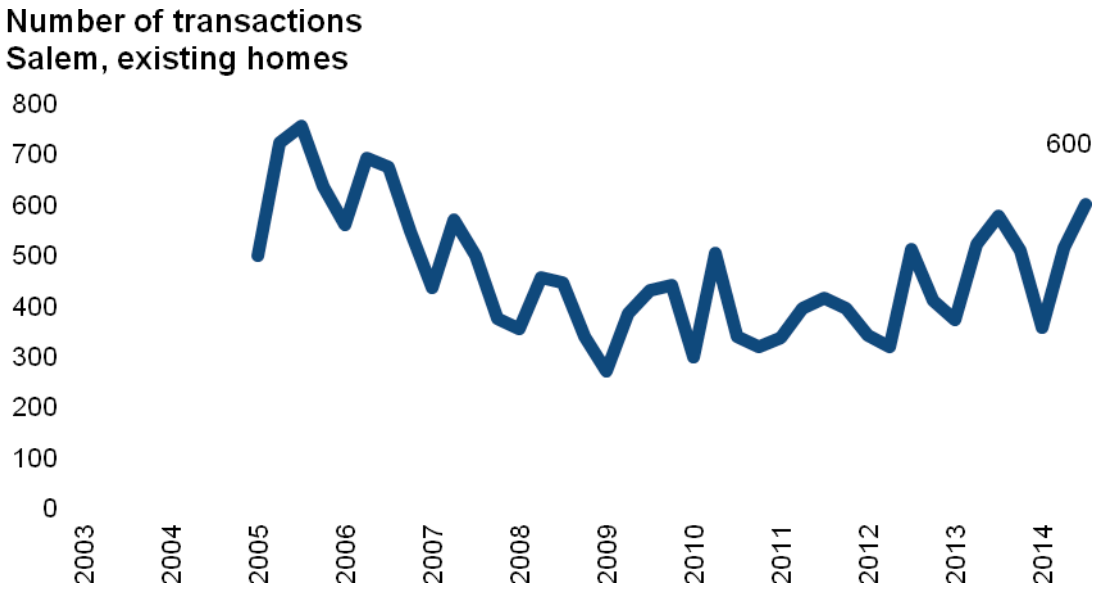

## WILLAMETTE VALLEY

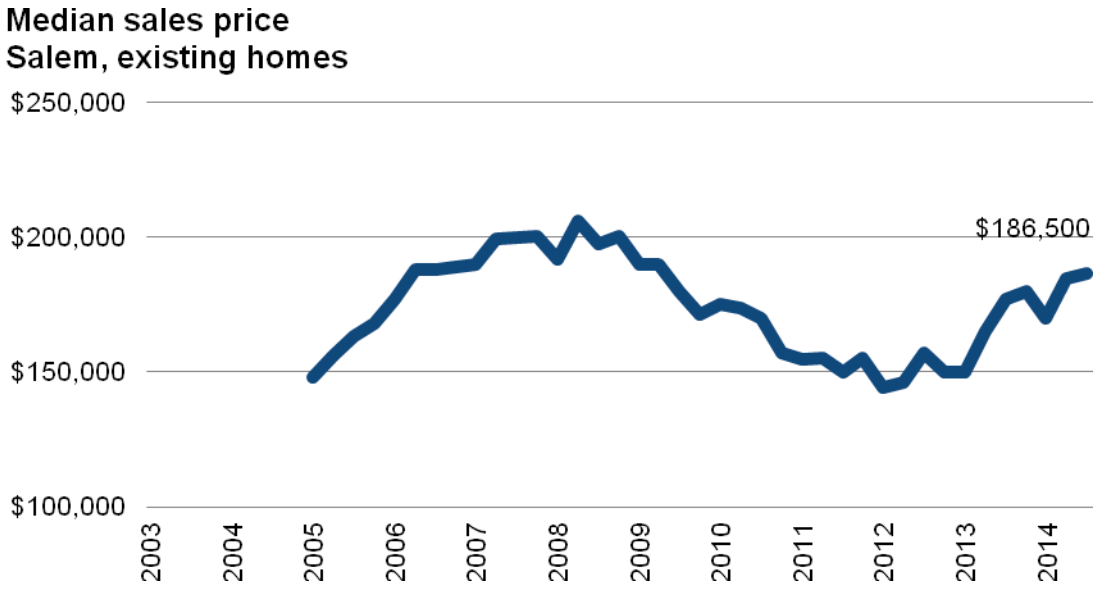
Polk County was the only area within the Willamette valley to show a decrease in median price. The decrease was marginal however as was the growth in the areas when compared to the second quarter of 2014. Most of the Willamette valley was flat relative to the third quarter of 2013. Marion County was the exception with an increase of 18 percent in median price from $170,000 in the third quarter of 2013 to just under $200,000 at $199,900 in the third quarter of 2014.

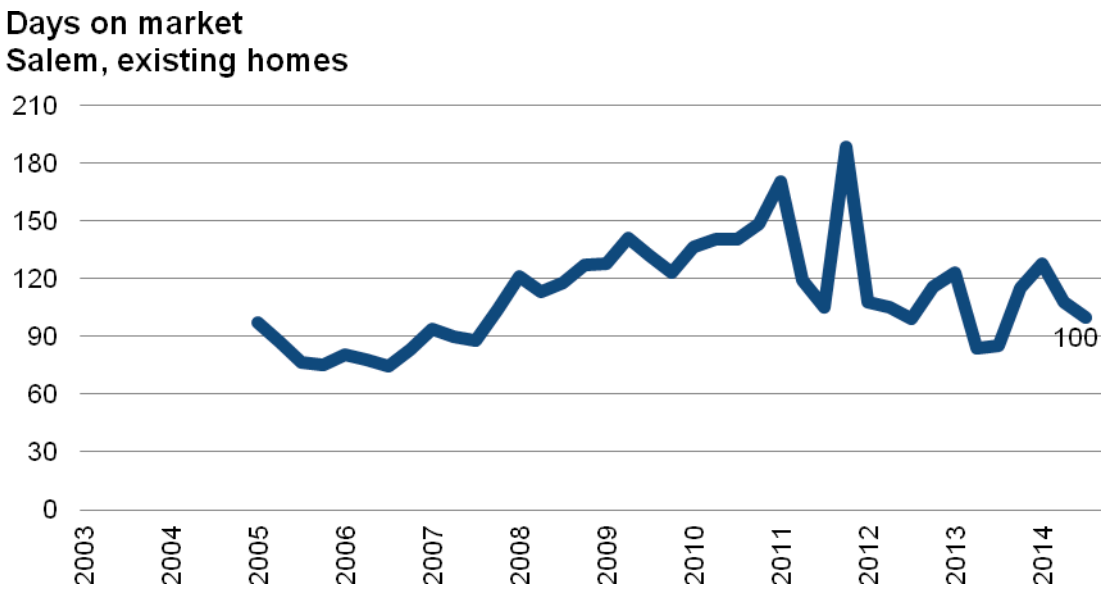

Median sales price
Willamette Valley, existing detached homes
$300,000
$250,000
$200,000
$150,000
$100,000
Benton
Lane
Marion
Polk
Linn
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

## SALEM

Salem posted the most transactions in the third quarter since the third quarter of 2006 with 600 transactions closed. The median price now stands at $186,500 and average marketing time is 100 days.

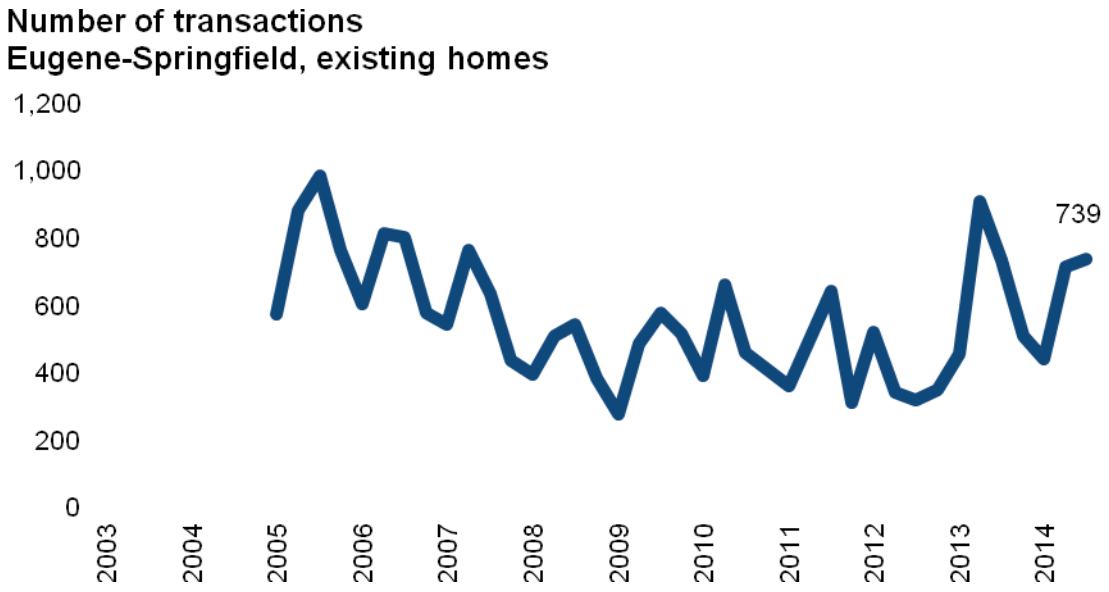



Median sales price
Salem, existing homes
$250,000
$200,000
$150,000
$100,000
$186,500
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

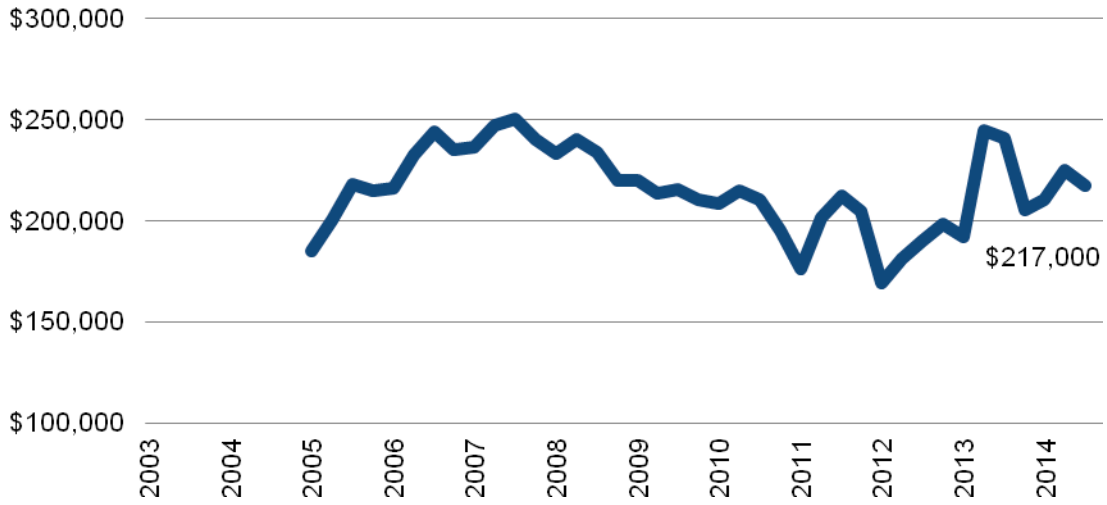

Days on market
Salem, existing homes
210
180
150
120
90
60
30
0
100
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

## EUGENE/SPRINGFIELD

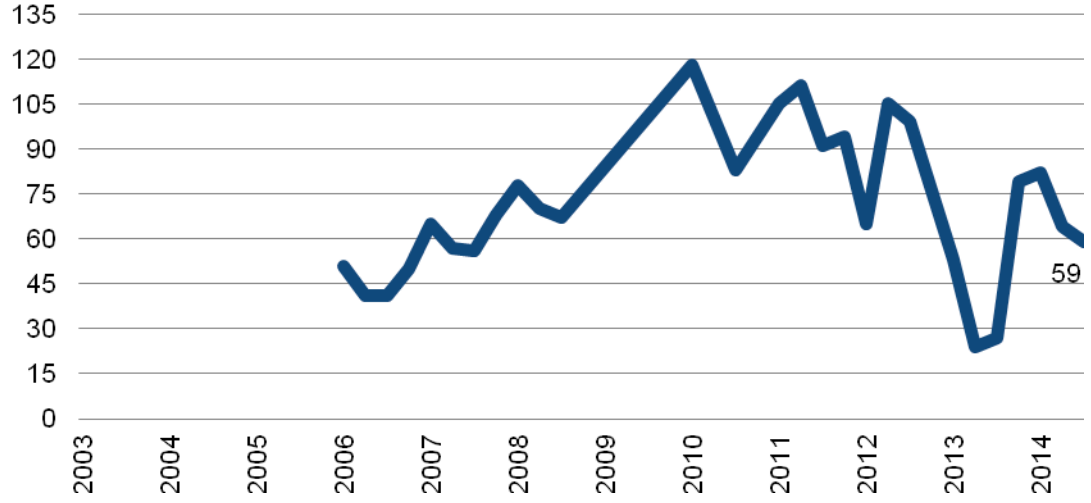
The median sales price in the Eugene/Springfield market dipped slightly to $217,000 on 739 sales during the third quarter. This market continues to show improvement but at a slower pace than other markets around the state.



**Median sales price**
**Eugene-Springfield, existing homes**




**Days on market**
**Eugene-Springfield, existing homes**



## SOUTHERN OREGON

As of August of 2014 Josephine County had a median sales price of $173,450. This was a 4.2 percent increase over the median of $166,500 in August of 2013. The average number of days on the market increased from 64 to 67 days

Over the same period, Jackson County's median sales price was $219,900. That is an increase of 11.9 percent over August 2014's median price of $198,450. Average days on the market increased 4 days to 47. ■

# MULTIFAMILY MARKET ANALYSIS

SCOTT HOLDEN

RMLS Student Fellow
Master of Real Estate Development Graduate Student

As I read through the numerous articles and data about the apartment market across the nation and especially Portland I began to see correlations to the Tech bubble of the late 90's. There are obvious difference, however. We are creating and building things of real value whereas the tech bubble was filled with worthless startups and speculators trying to cash in on the insatiable demand of investors. The tech bubble was spurred on by inexperienced entrepreneurs creating companies and what was thought to be new paradigms. Micro apartments and the relentless pursuit of sustainability regardless of cost or return both in monetary and environmental measures are different. Many would argue they are a response to proven long term demand.

Rents continue to rise as more and more people flock to the Portland area. I grew up here in the Portland area and remember a time when we did not welcome "outsiders" to our city or state. Despite our urban growth boundary and our anti-growth philosophies we grew and we continue to grow. There is rarely a top 10 list that Portland is not a part. Time and attitudes have changed and we now welcome

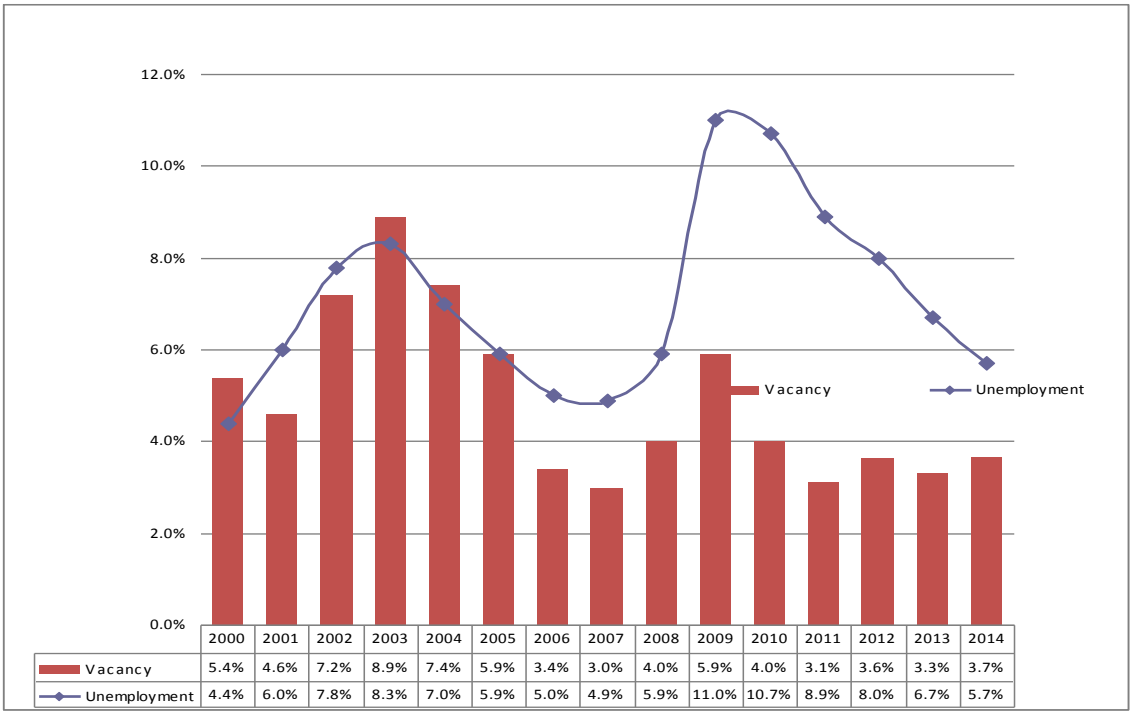
■ Scott Holden is a Senior Relationship Manager at First Republic Bank. He is currently working towards the Master of Real Estate Development degree through a joint program of the School of Business Administration and the School of Urban Studies and Planning where he is an RMLS Student Fellow. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

growth but now that we want it can we maintain it. Can we build and grow in a way that is economically, as well as socially and sustainably viable?

On the lending front it is now easier to qualify and buy a 5 unit property than to buy a 1-4 unit property. Many of the new rules in single family lending have created such barriers to entry that the average investor can more easily qualify for a 5 unit apartment than a rate and term refinance of their primary residence. In an area where a small apartment building will sell for $80,000 a door a 4 unit property is going for $125,000 a door.

Unemployment rates are positively correlated with vacancies as shown in the chart below. Portland currently has an unemployment rate of 5.7%; this is now below the national average of 5.9%. In addition, job growth in the Portland Metro area sits at 1.59%. The U.S. as a whole continues to lag at 1.18%.

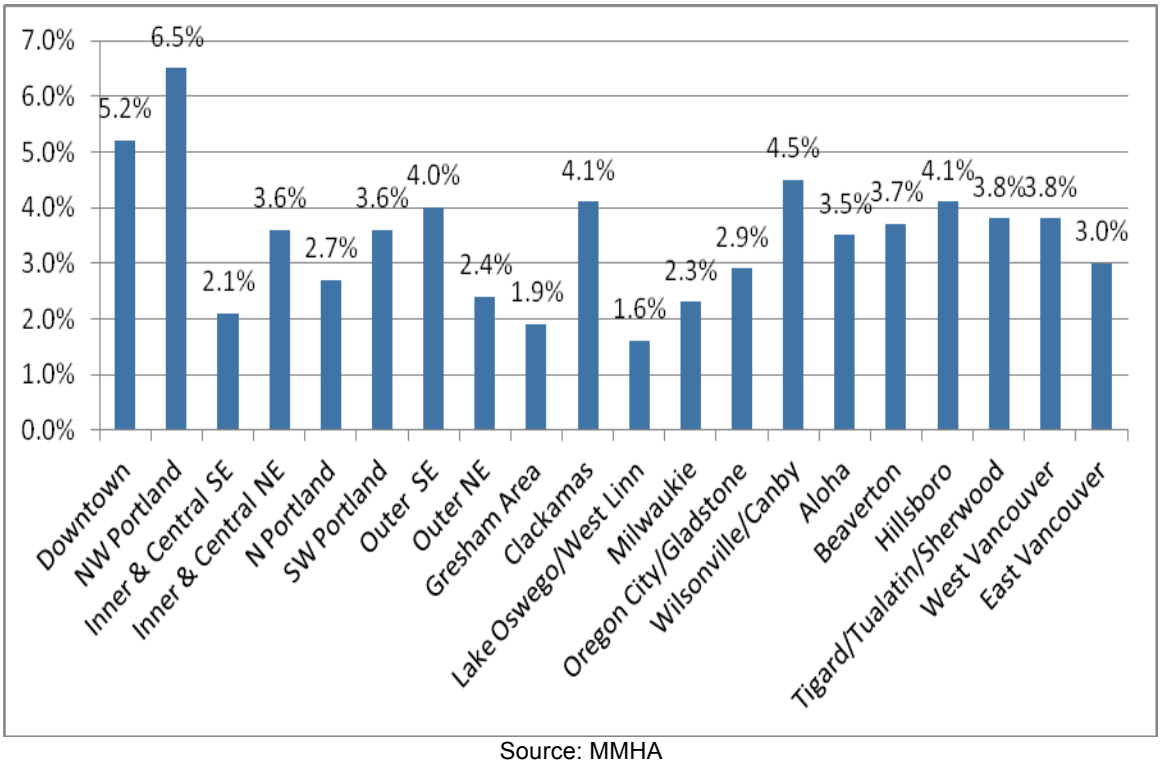
**Figure 1: Unemployment and Multifamily Vacancy, Portland Metropolitan Area**




| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Vacancy | 5.4% | 4.6% | 7.2% | 8.9% | 7.4% | 5.9% | 3.4% | 3.0% | 4.0% | 5.9% | 4.0% | 3.1% | 3.6% | 3.3% | 3.7% |
| Unemployment | 4.4% | 6.0% | 7.8% | 8.3% | 7.0% | 5.9% | 5.0% | 4.9% | 5.9% | 11.0% | 10.7% | 8.9% | 8.0% | 6.7% | 5.7% |

Overall vacancies rose slightly in the third quarter to 3.66% from 3.45% in the second quarter. Downtown and NW Portland have the highest vacancies at 5.2% and 6.5%. Lake Oswego and Gresham have to lowest vacancies at 1.6% and 1.9% respectively. 1 bed/1 bath units have the lowest vacancy by unit type at 1.55%. While 2 bed/1 bath units have the highest vacancy rate at 4.13%.

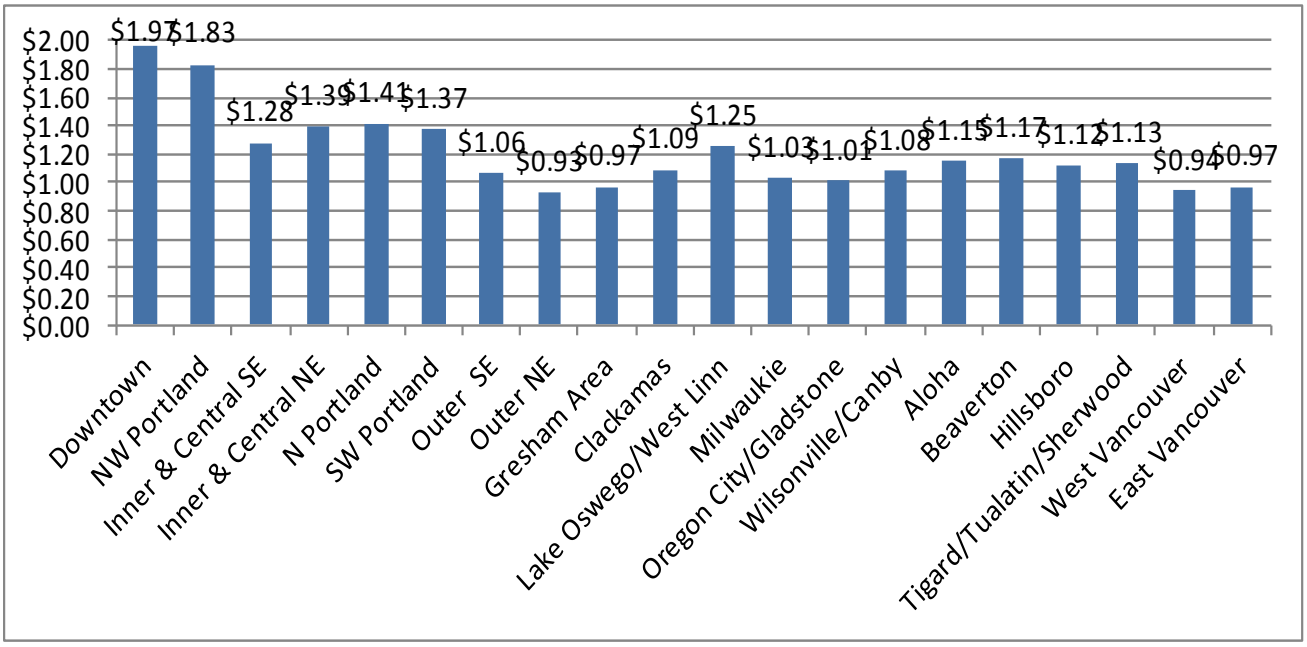
**Figure 2: Vacancy Rates by Submarket Fall 2014Portland Metropolitan Area**




Source: MMHA

As expected downtown and NW Portland continue to garner the most dollars per square ft at $1.97 and $1.83 respectively. Outside the inner areas of Portland West Linn and Lake Oswego deliver the highest rents per square ft at $1.25. Gresham and Vancouver are at the bottom of spectrum ranging between $.94 and $.97 per square ft.

**Figure 3: Rent / SF by Submarket Spring 2014 Portland Metropolitan Area**




Source: MMHA

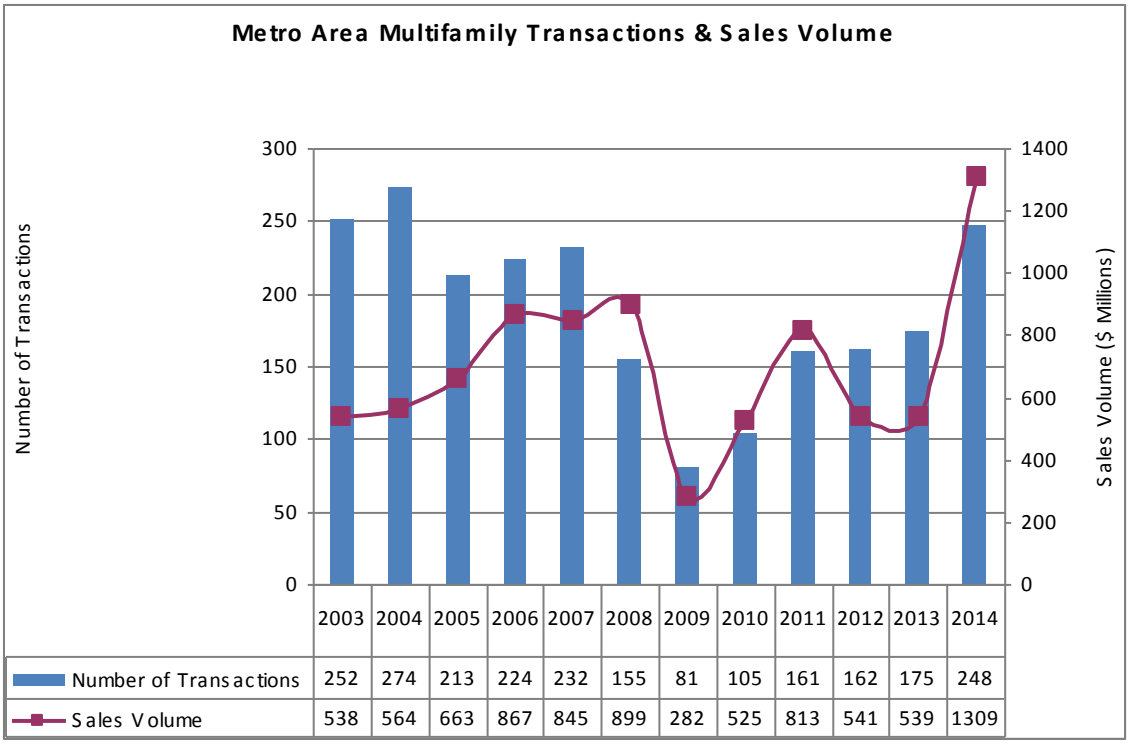
Transactions continue to be strong and are dominated by the large institutional players who now find Portland a worthwhile endeavor to invest their clients' money. Portland's growth in both population and jobs along with the presence of significant Fortune 500 companies such as Nike and Intel are all contributors to the interest. The main contributor, however, is the lack of opportunity and higher competition in the other west coast metropolitan areas. Portland is smaller than its neighbors but provides fundamentals and a west coast location that are currently hard to pass up.

| YTD 2014 Major Sale Transactions | | | | |
|---|---|---|---|---|
| **Building** | **City** | **Price** | **Units** | **Price/Unit** |
| Asa Flats and Lofts | Portland | $ 105,500,000 | 231 | $ 456,710 |
| Reflections at Summer Creel | Beaverton | $ 53,000,000 | 351 | $ 150,997 |
| Monteray Springs | Happy Valley | $ 51,250,000 | 390 | $ 131,410 |
| Seneca Village | Hillsboro | $ 51,000,000 | 264 | $ 193,182 |
| Westview Heights | Portland | $ 44,800,000 | 198 | $ 226,263 |
| Kempton Downs Apartments | Gresham | $ 27,000,000 | 278 | $ 97,122 |
| The Addy | NW Portland | $ 26,650,000 | 105 | $ 253,810 |
| Lewis Ridge | Vancouver | $ 15,790,000 | 112 | $ 140,982 |

Source: MMHA Fall 2014 Apartment Report

Sales volume is being driven by institutional buyers. The number of transactions is up over last year and if it remains on its current pace will hit 248. The volume tells the real story. At the current pace volume will end the year up 243% while the number of transactions will rise just 71%.

**Figure 4: Multifamily Transactions and Sales Volume, Portland Metropolitan Area, Through September 2014 (annualized)**



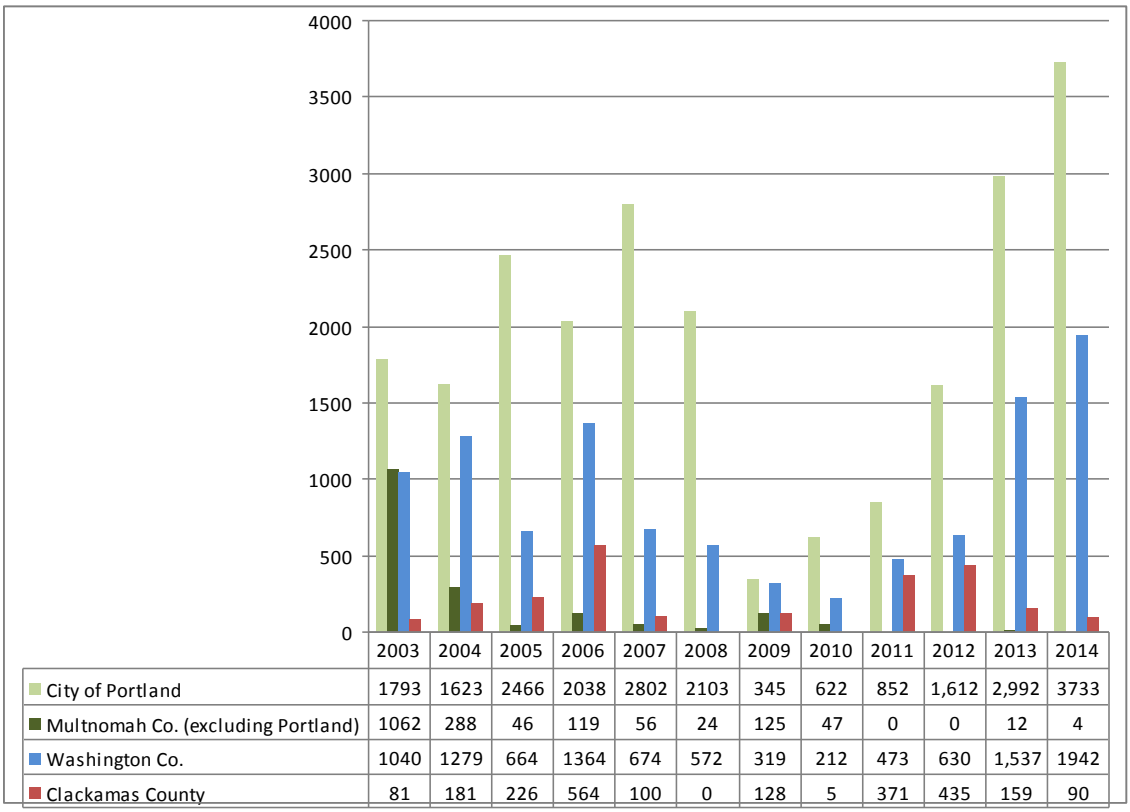

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of Transactions | 252 | 274 | 213 | 224 | 232 | 155 | 81 | 105 | 161 | 162 | 175 | 248 |
| Sales Volume | 538 | 564 | 663 | 867 | 845 | 899 | 282 | 525 | 813 | 541 | 539 | 1309 |

Source: Costar

Washington County and Portland continue to build although at a slower pace than in the second quarter. Portland is on pace to issue 3733 multifamily building permits in 2014 and Washington County is on pace for 1942 in 2014. That would be an increase over 2013 of 25% and 26% respectively. Multnomah County (excluding Portland) and Clackamas County continue to lag well behind.

**Figure 5: Multifamily Building Permits Issued, March 2014**

Number of permits through September 2014 is annualized




| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| City of Portland | 1793 | 1623 | 2466 | 2038 | 2802 | 2103 | 345 | 622 | 852 | 1,612 | 2,992 | 3733 |
| Multnomah Co. (excluding Portland) | 1062 | 288 | 46 | 119 | 56 | 24 | 125 | 47 | 0 | 0 | 12 | 4 |
| Washington Co. | 1040 | 1279 | 664 | 1364 | 674 | 572 | 319 | 212 | 473 | 630 | 1,537 | 1942 |
| Clackamas County | 81 | 181 | 226 | 564 | 100 | 0 | 128 | 5 | 371 | 435 | 159 | 90 |

Source: US Census

# OFFICE MARKET ANALYSIS

A. SYNKAI HARRISON

Portland State University

Colliers International reports that tech firms are continuing to be a major driving force in Portland's office market. According to the Portland Business Journal, tech companies are locating in spaces in and around downtown. As more firms compete for space, rents should continue to rise as choices become limited. If supply is unable to keep up with demand, potential tenants may find it increasingly difficult to fulfill space requirements which should bode well for owners. With decreasing vacancy and few projects currently under construction, large blocks of space will continue to be difficult to find.

The Portland Business Journal reported recently that Portland has jumped to the number eight spot of technology hubs in the country. Referencing a recent report from Jones Lang LaSalle, the Portland Business Journal states that the city has moved up from number 16 last year. This is due in part, according to the Journal, to Portland's "market dynamism" which is a mixture of high tech clustering, a mixture of amenities, walkability and vibrancy.

■ **A. Synkai Harrison** is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person or entity..

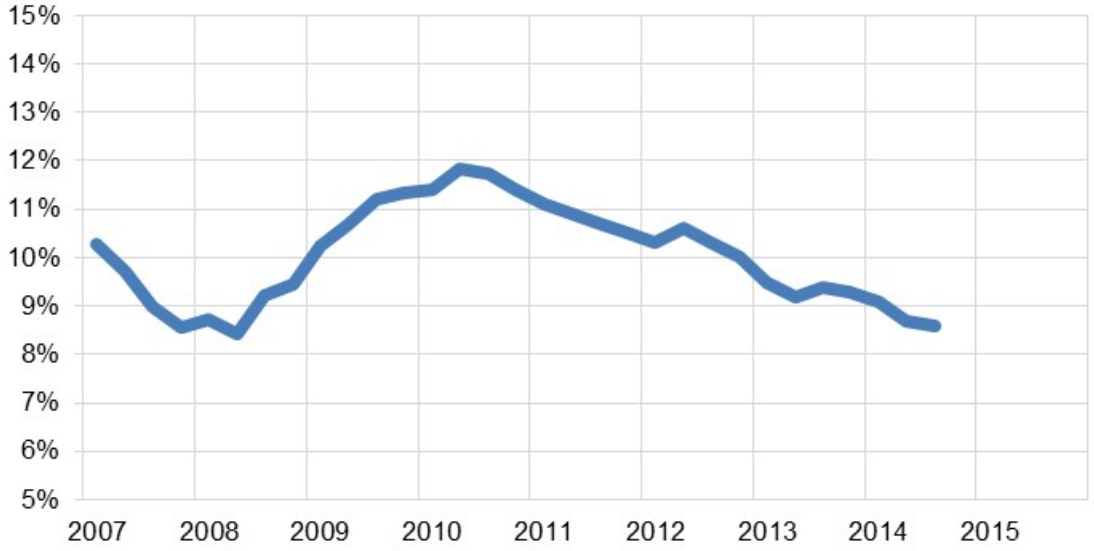
## VACANCY

Kidder Mathews reports an average vacancy rate for the office market of 8.6 percent at the end of the third quarter for the metro area. This is down from 8.9 percent last quarter and 9.5 percent in the third quarter in 2013. Jones Lang LaSalle is reports a total average vacancy of 10.0 percent. Marcus Millichap is reporting an average vacancy rate of 10.8 percent for the metro region. Norris and Stevens is reporting an average vacancy rate of 8.5 percent for the third quarter down from 8.8 percent in the previous quarter. CoStar is reporting an average vacancy rate of 8.5 percent at the end of the third quarter down from 8.8 percent at the end of the second quarter of 2014.

CoStar is reports a 10.2 percent average vacancy rate for Class A which has basically remained unchanged since the beginning of the year. Marcus Millichap has Class A average vacancy at 12.1 percent with Class B/C averaging 10.2 percent. Norris Stevens has Class A at 10.2 percent, Class B at 8.5percent and Class at C 6.7percent for the third quarter.

Norris Beggs and Simpson reports an average vacancy rate of 10.5 percent at the end of the second quarter for the Central City. Norris Beggs and Simpson reports a suburban market average vacancy rate of 14.03 percent. According to Norris Beggs and Simpson, the lowest vacancy rates for the suburban market were Central Beaverton at 8.76 percent, South Waterfront at 9.45 percent and the Sunset Corridor at 10.78 percent. Jones Lang LaSalle reports a total vacancy for the CBD of 7.7 percent down from 8.4 percent last quarter and 8.7 percent in the third quarter of 2013. Vancouver's office market came in at 11.41 percent according to Norris Beggs and Simpson.

**Figure 1: Portland Office Market Vacancy Rate, 2007–2014**




Source: Kidder Mathews

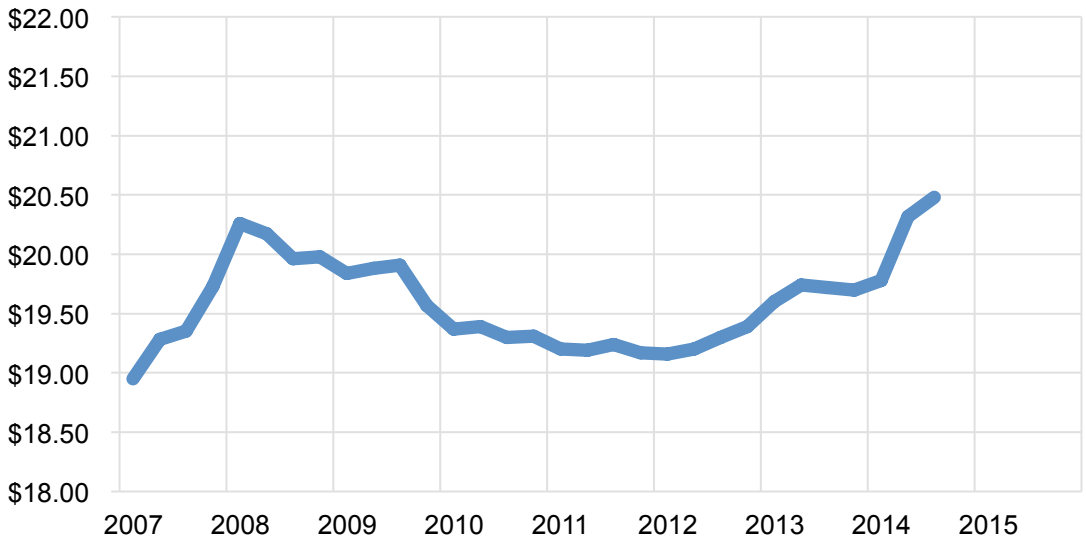
## RENTAL RATES

CoStar is reporting an average office rental rate of $20.66 per square foot which is a slight increase from the previous quarter of $20. 55 per square foot. Kidder Mathews reports average asking rental rate (FSG) of $20.48 per square foot, up from at $20.27 last quarter and $19.66 a year ago. Jones Lang LaSalle is reporting an average rate of $29.47 per square foot.

Kidder Mathews reported average rates within the CBD are $24.34 per square foot. Close in East side rental rates were averaging $20.29 during the third quarter. The I-5 Corridor averaged $22.40 per square foot. According to CoStar the average rental rate at the end of the second quarter for the CBD was $24.53 per square foot with suburban markets reporting in at $19.35 per square foot.

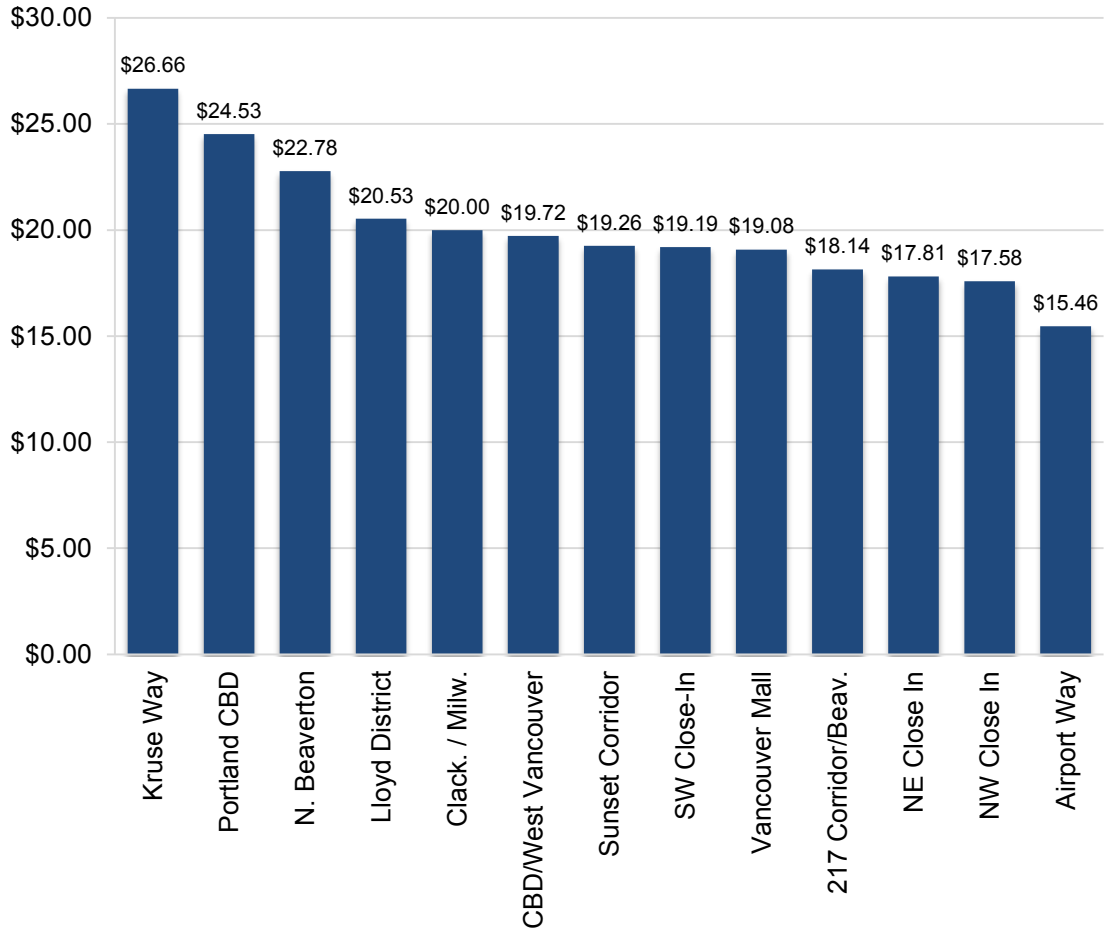
Class A office quoted rates according to CoStar averaged $24.89 per square foot for the third quarter of this year, up slightly from last quarter at $24.85 per square foot. Class B came in at $19.36 per square foot for the quarter up from $19.16 per square foot in the previous quarter. Class C improved slightly from $16.14 in the second quarter to $16.49 at the end of the third quarter as reported by CoStar.

**Figure 2: Portland Office Market Average Asking Rents, 2007–2014**




Source: Kidder Mathews

**Figure 3:Office Market Average Asking Rents in Portland Area Submarkets, 2007–2014**




Source: CoStar

## ABSORPTION AND LEASING

Kidder Mathews reports net positive absorption of 154,715 square feet during the third quarter down from 187,810 square feet last quarter. This is a significant improvement from the third quarter of 2013 where the market experienced negative absorption of 109,335 square feet. According to Colliers International, net absorption was positive 100,609 square feet overall for the Portland office market down from 315,595 in the second quarter and 262,487 in the first quarter of this year.

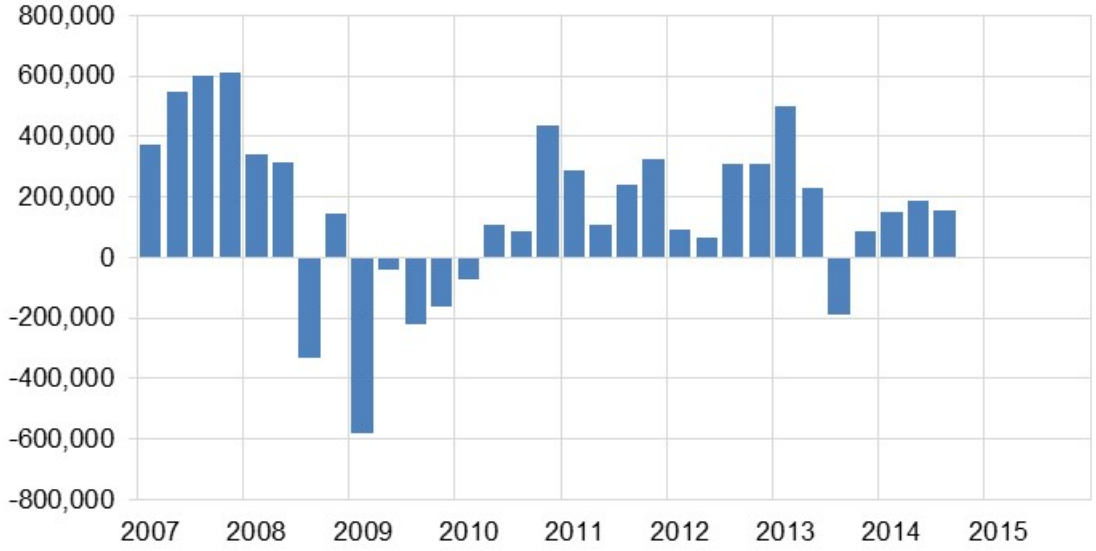
According to CoStar the Class A Portland office market recorded a net positive absorption of 1,954 square feet at the end of the third quarter as opposed to the

second quarter where there was positive absorption of 14,520 square feet and negative 68,289 square feet in the first quarter.

The Class B market experienced 102,266 square feet of positive absorption during the third quarter compared to positive 292,273 square feet at the end of the second quarter of 2014. Absorption was positive during the first quarter as well with 265,163 square feet of absorption according to CoStar.

The Class C office market experienced a modest 28,040 square feet of positive absorption during the third quarter compared to 85,723 of negative absorption at the end of the second quarter and positive absorption of 59,988 square feet in the first quarter according to CoStar.

**Figure 4: Portland Office Market Net Absorption, Square Feet, 2007–2014**




Source: Kidder Mathews-Values were adjusted to represent most recent report data

**Table 1: Notable Lease Transactions**

| Tenant | Address | Market | Size |
|---|---|---|---|
| Columbia Sportswear | Cornell Oaks Corp Center | Sunset/HBO | 48,885 |
| Hanna Anderson | Jantzen Park | CBD | 47,640 |
| ASML US Inc | Two Tech Center | Lloyd District | 48,893 |
| State of Oregon | Valley Plaza Center | Sunset/HBO | 43,519 |
| Umpqua | 72nd Corp Center | Tigard | 24,000 |
| Kaiser Permanente | Montgomery Park | NW Close In | 24,000 |

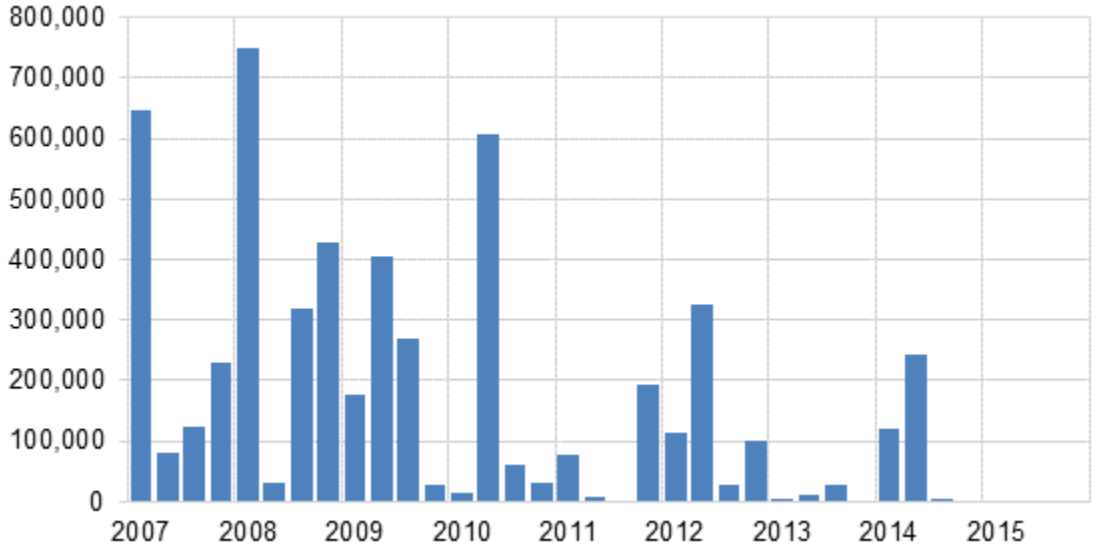
Source: Colliers International

**Table 2: Notable Sales Transactions**

| Tenant | City | Price |
|---|---|---|
| American Bank Building | Portland | $45,100,000 |
| PeaceHealth Building | Vancouver | $25,700,000 |
| Executive Bldg | Portland | $21,100,000 |
| Cornell West | Beaverton | $18,224,000 |
| 1320 SW Broadway St | Portland | $14,150,000 |
| 14th Overton Bldgs | Portland | $14,100,000 |
| Main Place Bldg | Vancouver | $12,150,000 |

Source: Colliers International

**Figure 5: Portland Office Market Deliveries, Rentable Building Area, Square Feet, 2007–2014**




Source: Kidder Mathews

## DELIVERIES AND CONSTRUCTION

Norris Stevens reports no new buildings were completed by the end of the third quarter compared to six buildings at the end of the second quarter. There were 438,935 square feet of office space under construction at the end of the third quarter according to Norris and Stevens up from 258,290 last quarter. According to Kidder Mathews there were no completions during the third quarter and that there are 438,935 square feet currently under construction. Marcus & Millichap reports that 81,000 square feet of office space has been brought to market so far in 2014.

Jones Lang LaSalle reports that much of the construction that is taking place in the office market is clustered in the Central City. Buildings are being renovated into "functional, unique spaces" and according to JLL, many of these projects are a mix of office, retail and multifamily. ■

# INDUSTRIAL MARKET ANALYSIS

A. SYNKAI HARRISON

Portland State University

According to Real Estate Investor Magazine many retailers are beginning to offer same day delivery for their products. As more retailers move to offer these types of services, the need for distribution centers and warehouses close to shoppers will grow. According Colliers International, "Portland has become an attractive intermodal hub in the growth of e-commerce distribution centers wanting to be closer to a growing population base".

## VACANCY

Costar reports an 5.6 percent average overall vacancy rate for Portland's industrial market. This is down from the past three quarters where the rate has remained at 6.0 percent. Capacity Commercial Group is reporting a 5.8 percent average vacancy rate in Portland's industrial market, down from 5.9 percent in the second quarter and compared to 6.4percent in the third quarter of 2013. During the first quarter of this year the industrial market experience a 5.7 percent average vacancy rate according to Capacity Commercial Group. CBRE reports 5.6 percent average vacancy rate at the end of the third quarter down from 6 percent at the end of the second quarter of 2014.

Norris Beggs and Simpson is reporting 7.52 percent total industrial vacancy for the metro area. Kidder Mathews is reports an average vacancy rate of 5.2 percent down from 5.75 percent in the last quarter and 6.2 percent in the third quarter of

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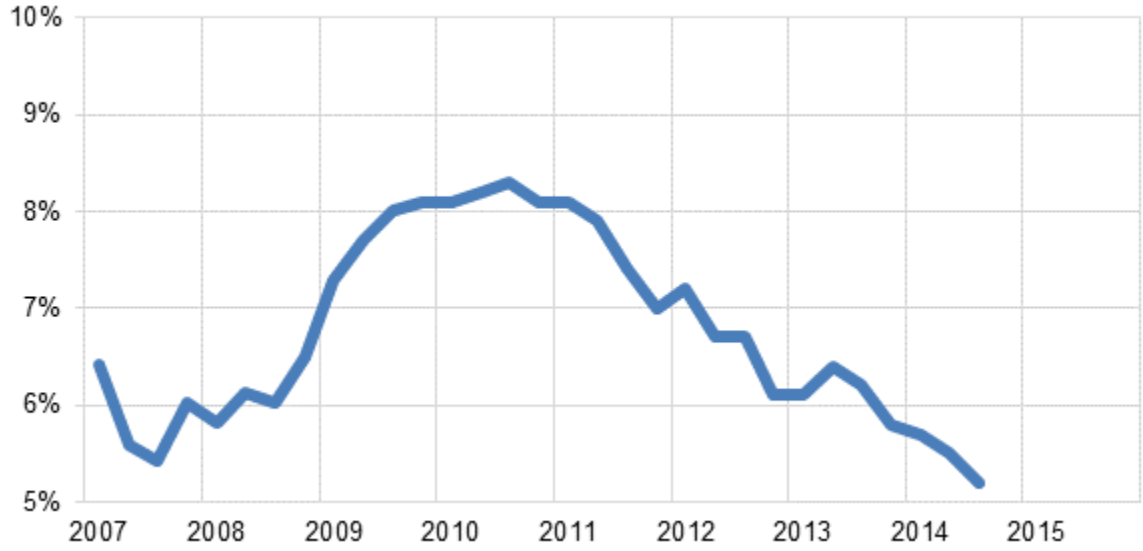
2013. According to Kidder Mathews, vacancy in the industrial sector has been trending downward since a peak of 8.7 percent in the second quarter of 2010.

Flex space experienced an of 11.9 percent vacancy rate according to CoStar compared to 11.5 percent at the end of the second quarter of this year. The first quarter of 2014 came in at 10.9 percent and the fourth quarter of 2013 at 11.0 percent vacancy rate according to CoStar. Norris Beggs and Simpson reports 11.3 percent overall total vacancy at the end of the third quarter 2014 for the flex market.

For warehouse projects, CoStar reports a 4.9 percent average vacancy rate at the end of the third quarter compared to 5.4 percent for the second quarter 2014 and 5.5 percent at the end of the first quarter 2014. At the end of the third quarter of 2013, CoStar reported an average vacancy rate of 6 percent for the warehouse market.

**Figure 1: Portland Industrial Market Vacancy Rate, 2007–2014**




Source: Kidder Mathews

## RENTAL RATES

At the end of the third quarter of this year, CBRE reports average asking rental rate of $.37 per square foot for the overall industrial market. Prices for distribution/warehouse space ranged from $.38 to $.45 triple net. Some older spaces, according to CBRE, are leasing at rates averaging between $.34 and $.36 per square foot with new facilities leasing closer to $.40 per square foot. For flex space, CBRE reports asking rates ranging from $.75 to $.85 per square foot, triple net.

Capacity Commercial Group is reporting an average lease rate for the overall warehouse market ranging from $.35 to $.37 per square foot.

**Figure 2: Portland Industrial Market Average Quoted Rates, 2007–2014**

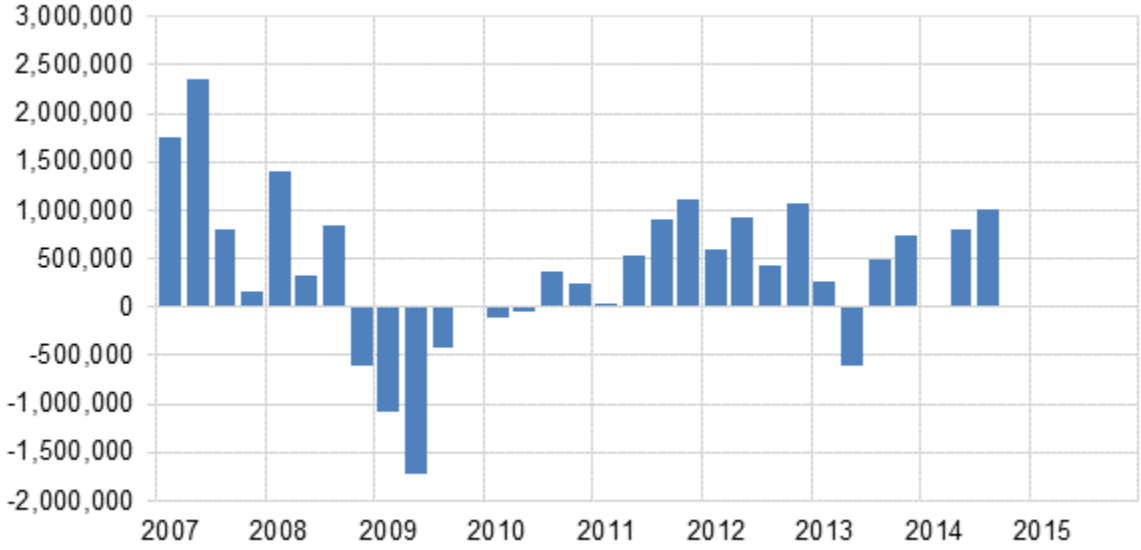

Source: Kidder Mathews

## ABSORPTION AND LEASING

Overall net absorption was positive 805,585 square feet at the end of the third quarter according to CoStar. This is an improvement over the second quarter of 2014 which ended with 509,697 square feet of positive absorption. The first quarter of this year ended with 29,368 square feet of negative absorption according to CoStar. Capacity Commercial Group reports 194,397 square feet of positive net absorption compared to 553,395 at the end of the third quarter of last year. At the end of the third quarter, Norris, Beggs and Simpson reports 927,428 square feet of positive absorption for the overall industrial market.

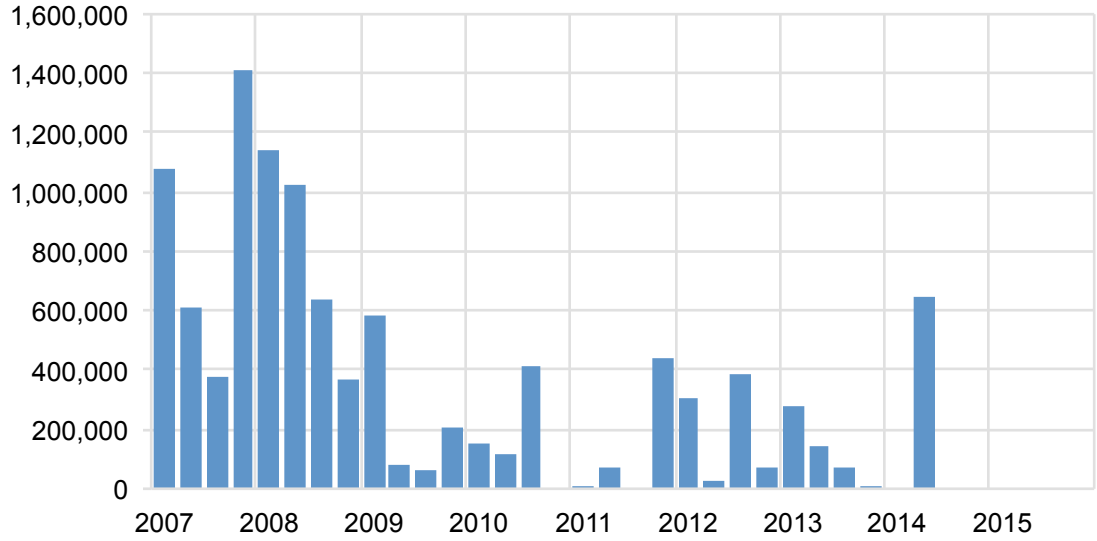
The flex market reports a negative net absorption of 65,568 square feet at the end of the third quarter according to CoStar. This was up from negative 82,372 square feet at the end of the second quarter. The first quarter of 2014 and fourth quarter of 2013 showed much better results with positive absorption of 18,542 square feet and 379,489 square feet of respectively. Norris Beggs and Simpson reports 44,439 square feet of negative absorption for the flex market during the third quarter of 2014.

**Figure 3: Portland Industrial Market Net Absorption, Square Feet, 2007–2014**




Source: Kidder Mathews

**Figure 4: Portland Industrial Market Deliveries, Rentable Building Area, Square Feet, 2007–2014**




Source: Kidder Mathews

**Table 1: Notable Industrial Lease Transactions**

| Tenant | Address | Market | Size |
|---|---|---|---|
| American Tire | Bldg A-Marine Drive Dist.Ctr III | Rivergate | 110,000 |
| Lam Research Corp | 20551 SW Wildrose Pl | Sherwood | 100,400 |
| Wymore Transfer Co | Bldg IV Columbia Comm. Cir | Airport Way | 73,928 |
| Kinco International | Bldg D Southshore Comm. Cir | East Col Corr | 68,019 |
| Boydstun Equip. Co | 8811 SE Herbert Ct | Clack/Mil | 52,750 |
| Benson Industries | 5530-5602 NE Skyport Way | Airport Way | 45,388 |
| Prestige Moving and Storage | Stafford Corporate Center | Wilsonville | 43,004 |

Source: Colliers International

**Table 2: Notable Industrial Sales Transactions**

| Building | City | Price | Type |
|---|---|---|---|
| Sunset Corridor Ind | Hillsboro | $22,254,371 | Owner/User |
| Pinnacle Exhibits Facility | Hillsboro | $6,750,000 | Investment |
| 1333 NW 12th Ave | Portland | $6,740,000 | |
| Rock Creek Industrial Park | Hillsboro | $6,540,000 | Investment |

Source: Colliers International

## DELIVERIES AND CONSTRUCTION

According to CBRE, there is at least one speculative project under construction in almost every submarket in the Portland metro area. Capacity Commercial Group reports that there is over 3.3 million square feet of industrial space currently under construction. According to CoStar no new buildings were delivered in the past quarter. Six buildings totaling 505,601 were delivered in the second quarter of 2014 and improvement over no buildings being delivered in the first quarter of this year. ■

# RETAIL MARKET ANALYSIS

A. SYNKAI HARRISON

Portland State University

Unemployment moved up slightly in July and August to 6.3 percent and 6.6 percent respectively but preliminary reports from the Bureau of Labor Statistics are showing a drop to 5.7 percent in September. According to Fortune Magazine, the US economy experienced a 3.5 percent jump in growth of real domestic product during the third quarter. This increase in growth was primarily due to increases in exports, government spending and consumer spending.

The National Retail Federation is predicting a 4.1 percent growth in sales this holiday season, according to Forbes Magazine. Total national retail spending could reach $616.9 billion by the end of the year. Fortune Magazine reports that consumer confidence is at its highest level in seven years. Falling gas prices, an improving labor market and higher consumer spending could all bode well for the future of Portland's retail market.

## VACANCY

Portland's vacancy rate remained virtually unchanged during the third quarter from previous quarters, coming in at 5.0 percent according to CoStar. The second quarter ended at 5.0 percent and the first ended at 5.2 percent. Colliers reports percentages with a 5.2 percent vacancy rate during the first quarter of this year and 5.0 percent in the second. Kidder Mathews is reporting a 5.0 percent and a 5.2 percent total vacancy rate for the third and second quarters of 2014. Norris Beggs and Simpson is reporting a slightly higher rate of 6.36 percent.

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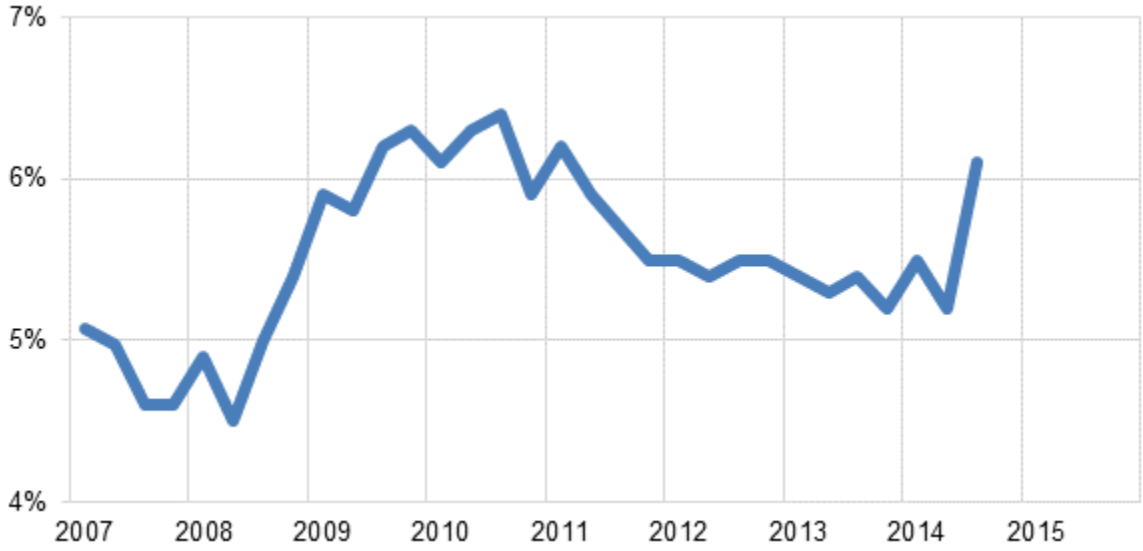
**Figure 1: Portland Retail Market Vacancy Rate, 2007–2014**



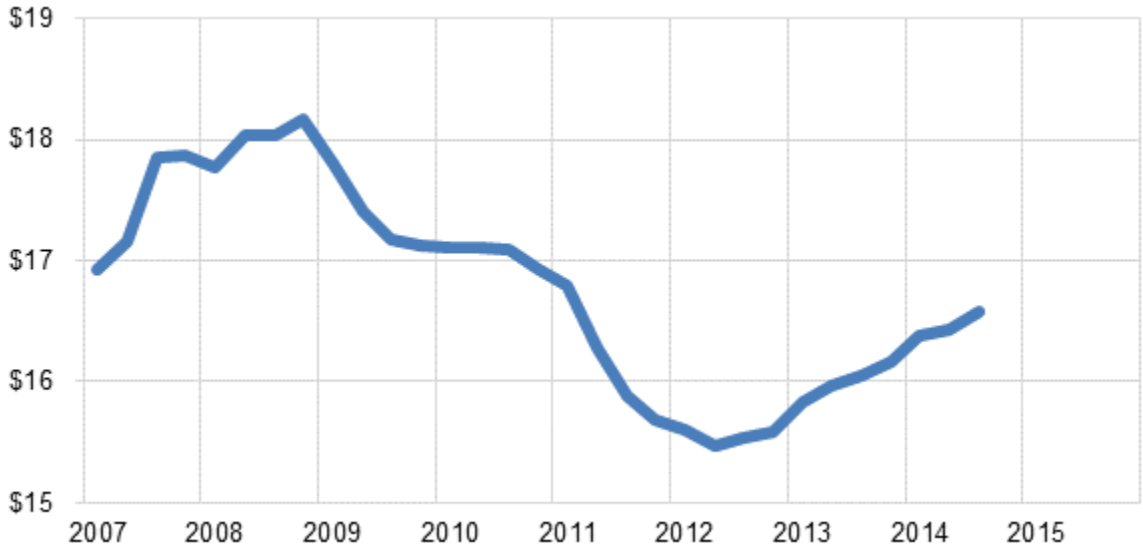

Source: Kidder Mathews

## RENTAL RATES

Colliers is reporting an average rental rate of $16.67 per square foot for all property types which is a slight improvement over last quarter which ended at $16.46 per square foot. The average quoted asking rental retail at the end of the third quarter according to CoStar was $16.62 per square foot compared to $16.45 per square foot end of the second quarter of 2014. Kidder Mathews is reporting an average asking rate of $16.58 triple net, up from $16.42 per square foot in the previous quarter and $16.03 per square foot a year ago.

In the shopping center market, CoStar reports an average rental rate of $16.89 per square foot for the third quarter of 2014 declining slightly from $16.91 per square foot for the second quarter. The average rental rate for the power centers market was $19.56 per square foot at the end of the third quarter and $19.47 at the closing of the second quarter. This is compared to $19.88 per square foot at the end of the third quarter of 2013, all according to CoStar.

**Figure 2: Portland Retail Market Average Quoted Rates, 2007–2014**

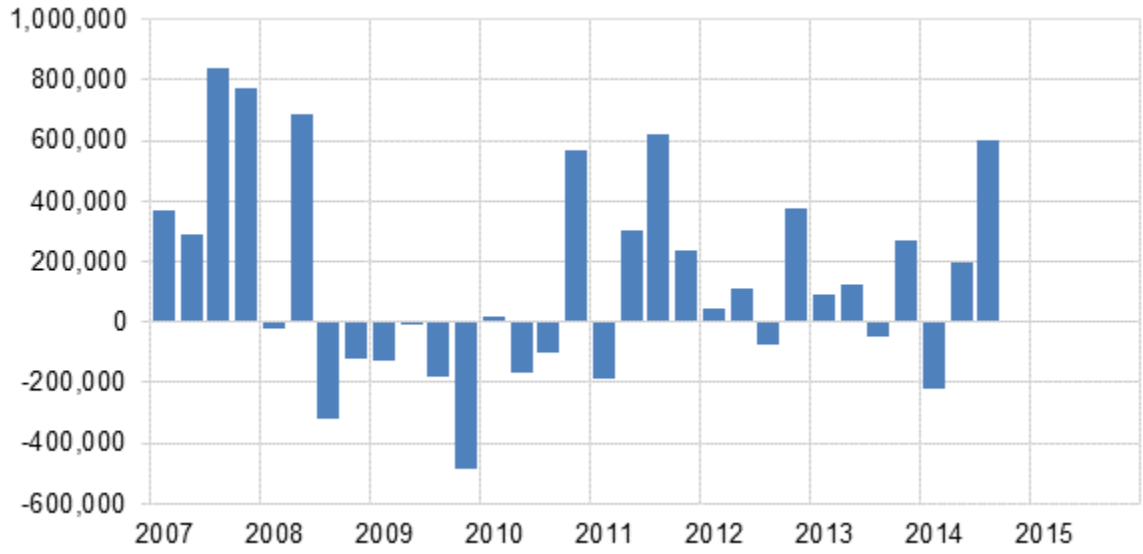



Source: Kidder Mathews

## ABSORPTION AND LEASING

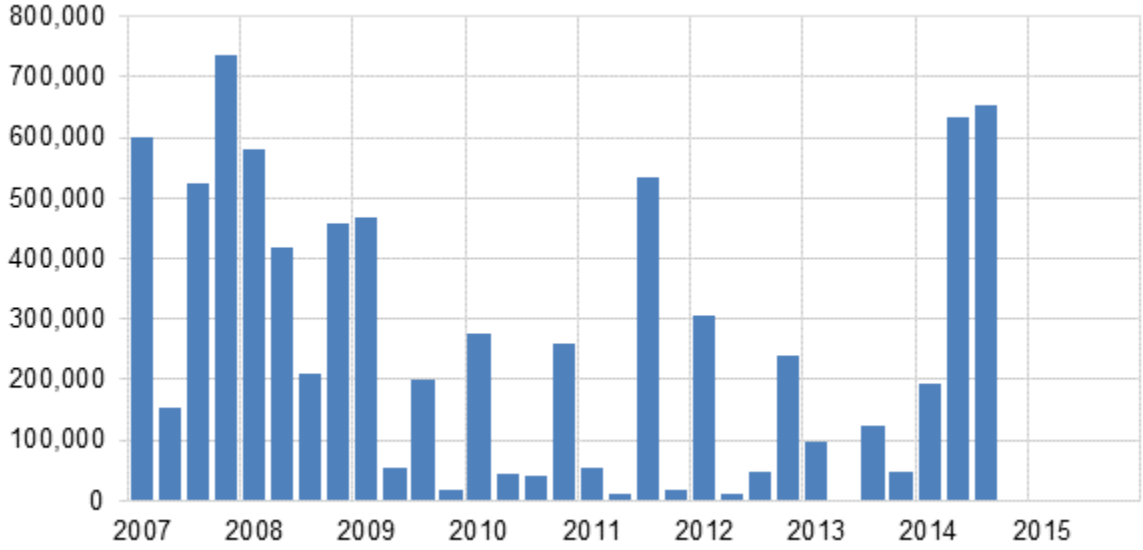
Net absorption appears to have been reasonably strong during the third quarter 2014. Kidder Mathews is reporting 602,690 square feet net positive absorption for the overall retail market. This was a significant improvement over the two previous quarters with only 138,588 square feet of positive absorption at the end of the second quarter and negative 218,546 at the end of the first quarter of this year. CoStar is reporting that during the third quarter of this year, the market experienced 561,712 positive absorption compared to 185,375 in the second quarter of 2014.

**Figure 3: Portland Retail Market Net Absorption, Square Feet, 2007–2014**




Source: Kidder Mathews

**Figure 4: Portland Retail Market Deliveries, Rentable Building Area, Square Feet, 2007–2014**




Source: Kidder Mathews

**Table 1: Notable Retail Lease Transactions**

| Tenant | Address | Market | Size |
|---|---|---|---|
| The Salvation Army | Evergreen Plaza | Orchards | 20,000 |
| Fat Head's Brewery | 131 NW 3th Ave | CBD | 11,300 |
| | 13898 NE28th St | Orchards | 10,000 |
| Storeables | Cedar Hills Crossing | Sunset Corr | 9,270 |
| Wunderland | Gresham Square | Gresham | 7,122 |
| Sola Salon | Cascade Market Place | Cascade Park | 6,630 |

Source: Colliers International

**Table 2: Notable Retail Sales Transactions**

| Building | City | Price | Type |
|---|---|---|---|
| Meier & Frank Bld, Nines Hotel | Portland | $127,000,000 | Owner/User |
| The Mall 205 &Plaza 205 | Portland | $76,500,000 | Investment |
| Hazel Dell Square | Vancouver | $27,650,000 | |
| Burlington Coat Factory | Portland | $13,180,000 | Investment |
| 150 SW Montgomery St | Portland | $10,000,000 | Investment |

Source: Colliers International

## DELIVERIES AND CONSTRUCTION

Eleven buildings were completed during the third quarter according to CoStar for a total of 622,864 square feet of space. Seven buildings totaling 24,119 square feet were completed during the second quarter and 13 buildings were completed for a total of 207,665 square feet during the first quarter of this year. Kidder Mathews reported 16 buildings delivered at the end of the third quarter for a total 651,862 square feet whereas only 21,119 square feet was brought to market and the end of the second quarter of this year. ■